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POSTWAR ECONOMIC POLICY AND PLANNING

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HEARINGS

BEFORE THE

SPECIAL COMMITTEE ON POSTWAR ECONOMIC  
POLICY AND PLANNING

HOUSE OF REPRESENTATIVES

SEVENTY-NINTH CONGRESS

FIRST AND SECOND SESSIONS

PURSUANT TO

**H. Res. 60**

A RESOLUTION CREATING A SPECIAL COMMITTEE ON  
POSTWAR ECONOMIC POLICY AND PLANNING

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**PART 8**

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APRIL 24, 26, 27, MAY 31, 1945

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**FINANCIAL PROBLEMS OF THE TRANSITIONAL PERIOD**

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# POSTWAR ECONOMIC POLICY AND PLANNING

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## REGULATORY OBSTACLES TO SECURITY INVESTMENT

By C. A. SIENKIEWICZ, Consultant

### A SUMMARY OF TESTIMONY, DISCUSSION AND FINDINGS

Congress in 1933 enacted the Securities Act and in 1934 the Securities Exchange Act, subjecting the processes of public sale of new and outstanding securities, with certain exceptions, to regulation by the Federal Government. "Truth in securities" has been the underlying objective that prompted the passage of these acts. The primary purpose has been to eliminate the abuses that had developed in the securities market over the years and to provide dependable sources of information for the investor.

The committee held hearings to determine whether the application and administration of the provisions of these acts by the Securities and Exchange Commission have been consistent with the intent and principles of the legislation. Witnesses<sup>1</sup> at these hearings emphasized the fundamentals of the law and the importance of the regulatory processes designed to promote high standards and equitable practices in the securities market. But at the same time they pointed out that certain rules and regulations have gone beyond the original intent and underlying philosophy of the legislation and have become needlessly restrictive to the flow of capital for commercial and industrial purposes. In their opinion the Congress should reexamine the acts in view of changed conditions brought about by the war and subsequent readjustment.

These witnesses offered in evidence samples of huge and unwieldy prospectuses, which few investors could be expected to read and understand even in their own protection. These samples served to dramatize the tale of restrictive and unnecessary over-regulation. The cost of such prospectuses for paper and printing alone is high, apart from the intensive research, accounting and legal work involved, for which the issuing business must pay. Long correspondence and discussions among underwriters, security dealers, lawyers, auditors, the issuing businesses, and the Securities and Exchange Commission; repeated trips to Philadelphia to consult the Commission; arguments on doubtful points, revisions and re-revisions of the prospectuses; and over all the uncertainty as to the effective date, the state of the market on that date, and the legality of disseminating descriptive information prior to the effective date—these were also cited as exam-

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<sup>1</sup> Hearings: Testimony of John Clifford Folger, April 26, 1945; of Emil Schram, April 27, 1945; statement filed by Ferdinand Eberstadt.

ples of meticulous and costly method of policing by the Federal Government of new security offerings.

The elaborate and highly technical registration statements now filed and the prospectuses now printed for distribution to the investor are such, all witnesses asserted, as to defeat the purpose of the law. In trying to read and understand this mass of material, the ordinary investor is baffled and must lean more and more on the investment counselor, a paid translating and interpreting service which the large investor can afford to patronize but the small investor often cannot. However unintentional, the methods and requirements that have been developed over the years apparently have resulted in undue annoyances, burdensome expenses, and discouragement of the wide distribution of securities among individual investors.

### *The process of security regulation*

The process of security regulation is a complex one. In order to make a public offering of an issue of securities subject to Federal regulation, a registration statement, containing the required facts, must be filed with the Securities and Exchange Commission. A prospectus for circulation to investors must also be prepared. These documents have two purposes: to enable the investor to inform himself and to create a public record as a basis for prosecution if misinformation is disseminated in connection with the selling process.

It seems that early in its history the Commission adopted the policy of giving guidance to the issuer and underwriter, so that statements would contain all required information and be drawn in acceptable form before being officially filed. Under this policy, which was intended to be cooperative, the Commission issues questionnaire forms, makes preliminary examination of the statements, and where indicated issues a "memorandum of deficiencies" leading to amendments and additional supporting documentation. More than one "memorandum of deficiencies" may be issued. A statement or prospectus thus may be returned for restudy and amendment again and again, so that the development of an acceptable document has tended to become a lengthy process, with a consequent rise in expense to the issuing concern and, in turn, to the investor. Another obvious consequence is a likely delay in placing the security on the market, which involves a risk of changed conditions and affects the prospect of a successful sale of the issue. If an enterprise has gone through this process on a previous issue, the Commission nevertheless requires that all information must be newly supplied since material already in its files on that concern may be outdated. This requirement, while possibly reflecting the fact that the position or condition of an enterprise may have changed, involves considerable repetition of data previously filed.

After the material has been filed officially, there ensues a formal waiting period; this was originally 20 days, but since the Securities Act was amended in 1940, it has frequently been made shorter by the Commission. This waiting period was intended by Congress to be an interval during which prospective dealers and investors could inform themselves about the securities. But the law provides that no "sale" may be made during this period and "sale" is defined in the act to include "every contract of sale or disposition of, attempt or offer to



dispose of, or solicitation of an offer to buy." A practical situation is thus presented whereby the mere explanation or appraisal of a prospective issue by underwriters to the distributors, and by dealers to their clients so nearly resembles a "sales talk" as to be likely to incur legal penalties. Consequently, the very information that is supposed to be spread during the waiting period cannot be so spread by those who are best informed without fear of infringing upon the law forbidding "sales."

Just before the end of the waiting period, amendments are filed containing price and other information that cannot be determined until the last moment. If an additional amendment is required, further postponement may ensue though this is not usual in practice. The final prospectus then is printed. It must be delivered to the Commission in connection with each sale made during the ensuing 12-month period, whether a first sale or a resale of the security, and irrespective of the size of the sale. No summary giving the main facts in brief form is now practicable because of the potential liabilities involved.

#### *The "area of agreement"*

At best this process of security regulation is both cumbersome and costly—one that may easily defeat its own purpose unless prudently administered. Much argument has surrounded both the basic system and its administration in the past; the documentation is formidable and attitudes have tended to become cemented by the controversy. A starting point toward adjustment and simplification of the system, however, was reached before the war.

In 1940, when various proposals to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 were before Congress, extended conferences were held between investment banking and dealer representatives on the one hand, and officials of the Securities and Exchange Commission on the other. In all, 86 proposed amendments were discussed and recorded in a 287-page volume issued by the industry and in a 53-page report issued by the Securities and Exchange Commission in 1941.

Agreement among the conferees was reached as to 35 proposals applying to the Securities Act of 1933 and 20 applying to the Securities Exchange Act of 1934. Some of the proposals would require amendments to the act, others merely changes in the regulations. Conditional agreement or only partial disagreement was reached as to some additional proposals. Some of these proposals require legislative action, while others may be handled through the regulatory powers of the Commission. As to some important proposals, however, there was failure to agree.

Of the proposals thus discussed in 1940 and 1941 only one has thus far been adopted by Congress, namely, the recent amendment exempting security issues of less than \$300,000 from registration but not from liability for fraud and misrepresentation, nor from the requirement that certain information be filed, and, of course, not from State regulation. Congressional consideration of the other proposals was interrupted by the outbreak of the war. The area of agreement, while it left many important differences of opinion unresolved, con-



stitutes a groundwork for remedial legislation designed to simplify and otherwise improve the facilities for the flow of capital for commercial and industrial purposes.

*Summary of proposed adjustments*

The committee has compiled a list of the more important unsolved problems, including some proposals that are within the area of agreement but not yet acted upon by Congress and others to which representatives of the SEC and of the investment banking industry apparently did not agree in 1940 and 1941. The committee drew from a number of sources in compiling this list. It requested Mr. Ferdinand Eberstadt, investment banker, to submit a memorandum on unsolved problems. It held hearings. Its staff discussed the issues with representatives of the SEC and with investment bankers. The major proposals advanced to the committee include:

(1) Raising the size of issues exempt from registration from \$300,000 to \$1,000,000. It is pointed out that this change would liberate risk and investment capital to many small issuers, especially medium-sized corporations, to whom the cost of the registration process is unduly high.

(2) Exempting from registration under the Securities Act of 1933 the issuance or sale of securities of companies which have already registered under (a) the Securities Act of 1933, (b) the Securities Exchange Act of 1934, (c) the Public Utilities Holding Company Act of 1935, and (d) the Investment Company Act of 1940; provided such companies have kept their registration up to date by annual filing of reports. This exemption would extend the principle adopted by the Congress in 1933 with respect to issuers of railroad and national-bank securities to other issuers of securities who, through the operation of other new Federal statutes, are now making disclosure of all essential facts concerning their affairs through the medium of registration statements and periodic reports. It is stated that this would not only obviate the costly and unnecessary duplication incident to dual registration but that it would also operate to enable smaller investors to compete with large financial institutions for the substantial volume of industrial issues which are now being distributed through so-called private placement in consequence of a provision of the act which exempts from registration sales by an issuer which do not involve "any public offering." This in turn would make more high-grade securities available to many smaller institutions and to private investors and thus tend to decentralize ownership of the securities of business and industry. It is further pointed out that the proposed exemption would in no sense deprive the investor of adequate safeguards.

(3) Making the last-minute filing of certain specific information (usually the offering price, and information related thereto) automatically and immediately effective without the approval of the Commission. The purpose is to eliminate the final interval of time in which the market may change. How essential it is for the Commission to pass upon price information is the question involved.

(4) Eliminating the filing of business contracts as exhibits unless they are genuinely material. As a general rule, contracts of issuers are not required to be summarized in prospectuses, yet they must be printed and filed with the registration statement, and the definitions

and interpretations of materiality are such as to require the inclusion of a vast mass of documents. Their value to the investor, who is said seldom to consult these contracts, is questioned, and it is also alleged that business competitors thus may obtain knowledge of an enterprise's inner affairs. The contracts, however, may become necessary as a basis of prosecution or civil suit if misrepresentation as to such contracts should occur, but presumably might be subpoenaed if such charges were brought.

(5) Abolishing schedule A in the Securities Act. This schedule sets forth in considerable detail informational requirements which are said not to be equally applicable to all types of enterprise. The requirements may at times be waived, but it is pointed out that if the Commission were free to determine the requirements for each separate type of business on the basis of its experience, rigid standards that do not fit particular business situations would be more generally avoided.

(6) Amending the act to forbid the alleged tendency of the Commission to establish uniform accounting procedures through indirect pressures, though no authority to do so is granted by the law. Whether uniform accounting is necessary to full disclosure is the issue involved.

(7) Registering issues or parts of issues for future as well as for immediate sale. This is advocated as a means to substantial saving in expense and trouble. The Commission now forbids this practice on the ground that the registration statement might be outdated by the time the temporarily withheld securities are offered for sale. But this point could be covered by the later filing of amendments to the original prospectus.

(8) Amending the act to permit better dissemination of information prior to the effective date. Several amendments are suggested as actually conforming to the informational purpose of the waiting period better than the existing provisions. Specific suggestions are: (a) That underwriters be permitted to consult prospective dealers, to furnish them with information in summary form, and to make tentative preliminary agreements as to the distribution process; (b) that the making of offers be permitted on the basis of the prospectus after its deficiencies have been corrected, but not the acceptance of such offers; (c) that the use of a limited or summary prospectus be permitted both before and after the effective date; (d) that prospectuses be permitted to include graphs and illustrations, and to be drawn in a readable rather than in an involved legal style; (e) that advance advertisements, more detailed than the meaningless "tombstone advertisement," be permitted if previously inspected by the Commission; (f) that an underwriter or dealer who has participated in the distribution of an issue registered under the 1933 act not be required to use a final prospectus in connection with sales made after he has completed distribution of the securities underwritten by him or obtained through his selling group participation; (g) that the necessity for sending or giving an additional final prospectus to any person who has already received one from any source relating to the securities sold to him be eliminated.

(9) Removing the legal uncertainty as to whether the underwriters' liability applies to investment trusts and other investors who purchase securities with the intent of holding them, but resell them after a time.

(10) Requiring a certain proportion of the Commission's members to be persons with substantial experience in the securities business. This could be accomplished by enlargement of the Commission. Such enlargement also would enable proposed issues to be more promptly cleared.

(11) Amending section 12 (2) so that its liability provision relating to outstanding securities would conform in general to the provisions contained in section 18 of the 1934 act. It is pointed out that this would make more practicable the dissemination by dealers of more information about outstanding securities than is now practicable in view of the liabilities involved.

(12) Taking measures to simplify the registration procedure. This appears to be a matter for administrative action rather than for statutory change. It is believed that reform here should be accomplished by a review of all of the registration forms, questionnaires, and other documents employed by the Commission having as its purpose the elimination of questions requiring the submission of material which is not necessary for the information of investors.

#### COMMENTS AND RECOMMENDATIONS

It appears that an essential regulatory function of the Government has become to some extent obstructive of the channels through which the public may invest its funds in the corporate business and industry of the Nation. Because of the many implications of this situation to the successful functioning of our economy, it is believed that appropriate action should be taken, to the extent practicable and consistent with proper safeguards for the public and investors, to remove the existing obstacles to the orderly flow of capital to meet commercial and industrial requirements.

The obvious remedy necessitates, first of all, the sound amendment of the basic statutes, a complex and difficult job at best. But a good beginning was made in 1940 and 1941, as the result of the conferences between the industry and the Commission. It would seem that the time is ripe for a review of the proposals, conclusions, and agreements reached at that time and for the conclusion of that work.

It is accordingly recommended:

(1) That this part of the committee's study, together with the record of the hearings on this subject, be referred to the appropriate committees of the Senate and House of Representatives for their information and consideration;

(2) That such committees consider, at the earliest practicable date, the more immediate and important unresolved problems listed in this summary with a view to arriving at appropriate solutions through legislative action where necessary; and

(3) That as soon thereafter as possible all of the remaining proposals made in 1940-41 as a result of various conferences between investment banking and dealer representatives, and officials of the Commission, as well as any new ones which may be developed in the interim, be reviewed for the purpose of seeking and taking such remedial legislative action as the Congress may deem necessary.



# POSTWAR ECONOMIC POLICY AND PLANNING

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TUESDAY, APRIL 24, 1945

HOUSE OF REPRESENTATIVES,  
SPECIAL COMMITTEE ON POSTWAR  
ECONOMIC POLICY AND PLANNING,  
*Washington, D. C.*

The special committee met, pursuant to adjournment, at 10:15 a. m., in room 1012, New House Office Building, Hon. William M. Colmer (chairman) presiding.

Present: Representatives Colmer (chairman), Voorhis, Murdock, Gifford, Reece, Welch, LeFevre, and Simpson.

Also present: M. B. Folsom, staff director.

The CHAIRMAN. The committee will come to order.

## STATEMENT OF JOHN F. FENNELLY, CHAIRMAN, SMALL BUSINESS COMMITTEE OF THE INVESTMENT BANKERS ASSOCIATION OF AMERICA

The CHAIRMAN. We are glad to have Mr. John F. Fennelly with us this morning. Mr. Fennelly needs no introduction to this committee. We recall very pleasantly the profitable work he has been doing with the CED and its other forward-looking committees who are working on the postwar problems.

Mr. Fennelly, we are glad to have you here this morning, sir. You may use the time as you see fit. If you have a prepared statement, we will be glad to hear it. At the conclusion of your statement, I am sure there will be some questions that we desire to ask you.

Mr. FENNELLY. Thank you, Mr. Chairman. I consider it a great privilege to testify here today on the problems of the postwar financing needs of business. It is a subject that I have been giving intensive study to for some time, first, as you mentioned, as Director of CED, and as an individual investment banker, and most recently as chairman of a special committee of the Investment Bankers' Association of America, set up to study postwar financing needs of business, with particular reference to the needs of small business.

Now, Mr. Folsom was kind enough to give me some questions around which he thought I should organize my remarks of this morning, and I propose to follow them in a general way.

The first question that he asked was what type of financing may be needed—equity, long-term borrowed capital, medium- or short-term credit.

Mr. Chairman, as an investment banker, I am concerned with the problems of long-term capital, either in the form of long-term bor-

rowed capital or equity capital, and I think it will be appropriate if I confined my remarks to those fields, leaving the problems of short-term credit to those more capable of discussing them. When it comes to the question of what kinds of long-term capital are going to be needed, I think the only answer that can be given is all types.

One thing I am convinced of is that the demand for capital for business in this country is going to be very great. It is obvious that it must be large if we are going to attain a very high level of employment after the war. That is one way of approaching the subject, because it is perfectly clear that even with our war expansion we won't have the capital and facilities—plant and facilities and working capital—to carry on such a high-level economy unless there is actual investment of substantial amounts of capital.

Another way of approaching it, which is more convincing to me, is through the experience of traveling around the country and talking with many hundreds of businessmen as I have during the course of the last 2 years, and I have become convinced—really astonished—at the degree to which business in this country is making postwar plans for a period of great expansion. Everywhere I go I am really astonished to see the progress that has been made in thinking and planning for an expanded economy. I think I could put it by saying that it seems to me business is literally straining at the leash to go ahead as soon as it get the green light.

Now, obviously, it can do no more today, and should do no more, than make plans; but I want to assure this committee that it is tremendously impressive to go around the country and see the extent to which business is planning for an expanded economy.

Obviously, also, you can't expect that expansion to go ahead unless there is at least a moderately favorable climate of national policy. I don't want to belabor that point too much. I know it has been made before the committee many times. I do want to mention three things that seem to me to be fundamental if business is to go ahead and carry out the plans that it now has made.

One, a sound revision of a tax system. I don't even propose to mention that in detail today. I think that is obvious to all the members of the committee, as it is to everybody in business today.

Second, a detail that hasn't been mentioned I think nearly as much as it should have been is an intelligent handling of the public debt. I don't mean just a cessation of the growth of public debt after the war which, naturally, all of us hope is to be achieved at as early date as possible, but I mean actual sound handling in the funding operations of the debt, so that business will have confidence that it has a stable base upon which to operate.

Third, I would stress avoidance of governmental guaranty of employment. I think that paradoxically enough that if business is to do its full share in providing a satisfactorily high level of employment, one of the things that could be most certain to prevent it from going ahead with its expansion plans would be an over-all guaranty by the Government of full employment.

The CHAIRMAN. Pardon me, would you repeat that last statement, please?

Mr. FENNELLY. I said that I think the surest way to check the present enthusiasm of business to go ahead would be a governmental guaranty of full employment.

The CHAIRMAN. I just wanted to be sure.

Mr. FENNELLY. Now, to get down again to somewhat more specific details, it does seem to me that of the various types of financing needed by business, the most important one is equity capital and the need will be for equity capital both on a large scale and for small business. Facilities available for debt financing are today tremendous. All the institutions of saving are bulging with funds to take care of long-term loans. Also, the tax system for the last 10 years has more and more favored debt financing rather than equity financing, and it seems to me the greatest emphasis from many different points of view should be on equity financing to the greatest possible extent in the postwar period.

Now, as our institutional structure is set up today, that means considerable reliance, very heavy reliance, on the individual investor rather than on institutional investors because there are very few institutional investing organizations, relative to the total amount of capital available, that are set up to handle equity funds. I am not greatly concerned about that because it seems to me that we are going into a period where the individual has and will have substantial sums to invest, and it seems to me largely a matter of reaching him, in other words, finding the capital in the hands of individuals through proper distribution procedure in order to reach that source of equity funds.

Now, the next question that Mr. Folsom put to me was, What facilities are available to provide the needed financing? There are some that are immediately obvious. In the first place, there is the investment banking machinery today that is at the present time in a state of vigorous health. That machinery, it should be clearly understood, is not an investing machinery. It is a distribution machinery. I will come back to that again in my discussion later, but the mistake is often made in thinking that the investment banker is an investor as such. He is not. He is a merchant of securities, a channel through which securities are passed from the issuing companies to the ultimate investors.

Turning to the ultimate investors, I repeat that we have a situation with tremendous resources and capital funds in institutional hands which are readily available to make high-grade investments. I think somewhat unfortunately—although I wouldn't want to stress the point too much—confined to the purchase of evidences of debt rather than of equities.

That is a complex problem, and I don't care to attempt to pass judgment on it.

I have already spoken of the rebirth of the individual investor who, I am sure, will be glad to come into the market and buy equities in very substantial amounts, provided he has a tax structure after the war that gives him some confidence that the purchase of equities and the taking of risks is a worth-while operation, which it is not today. Now, I have seen a great many estimates of what the volume of postwar financing may be. I don't feel competent—I, frankly, don't think anybody is—to make any intelligent guesses as to what it will be. I think it will be vastly greater than it was during the period of the thirties, and I am inclined to think that it will be even greater than it was during the period of the twenties.



I know that there are many economists that take the position that they are very much afraid that the proper amount of investment won't be forthcoming for a high level of economy of—let's say—30 to 40 percent above the prewar level. These prophets of stagnation, as I think they should be called, it seems to me, are putting the cart before the horse. I am convinced that if we do get a satisfactory economic climate, if business is given an opportunity to go ahead, the problem will be rather the reverse, one of finding the funds needed to meet the investment opportunity rather than a fear that the investment funds won't be available to meet the opportunity.

The next question I have been asked to answer by Mr. Folsom is: What do you anticipate as the principal difficulty in providing the needed financing for business in the transitional and early postwar period?

I have studied that question a good deal, and I don't see—with one exception that I propose to come to, and that is in the area of small business—that there are any special difficulties that appear today in the capital market.

All the larger companies that have legitimate claims for financing are getting it with the greatest of ease. In fact, the other day the SEC expressed some fear that a great many highly speculative securities were being issued and readily absorbed by the public, that they felt should be questioned and the public should know they were of a highly speculative kind.

To a degree, that is obviously a very healthy thing. We do want capital to flow and people to be inspired again to take risks. I think it is important that the SEC should put out warnings that such securities are not guaranteed or approved by the SEC and are highly speculative, but I mention that only to say that the general atmosphere on the part of the investing public and on the part of the institutional investors seems highly favorable to an active supply of capital to meet the demands.

Now, that is all said with one qualification, which brings me to the next point I want to make, the major part of my statement today.

In studying these facilities for channeling funds from the ultimate investing public, we in the Investment Bankers Association have become convinced that there is a real gap in the machinery and that that real gap comes in connection with the ability to provide the needed capital, long-term capital and equity capital, for small business of this country.

In an attempt to come to grips with that problem, as I said at the outset, I have been serving as chairman of a special committee of IBA that has been studying the problem for the last several months. As a result of our study we have evolved a plan which we believe is sound and constructive for providing capital for small business in the postwar period.

I should like to take the liberty here before this committee of making the first public presentation of this plan, Mr. Chairman. It is a plan that has been unanimously approved by this special committee, has gone before the board of governors of the Investment Bankers Association, and has been unanimously approved there, and with your permission I would like to high light that plan, because we are con-



vinced that it is the one important gap that exists today in the financing machinery for providing the needed capital for business after the war.

The CHAIRMAN. We will be glad to hear you.

Mr. FENNELLY. The plan is as follows:

### CAPITAL FOR SMALL BUSINESS

#### SUMMARY OF CONCLUSIONS

I. Despite the scarcity of statistical evidence, we are convinced that small business in the United States is likely to face serious difficulties after the war in obtaining the capital which it will need for reconversion and postwar operations. We are also convinced that unless private business in cooperation with Government can find a satisfactory answer to this problem, some solution will be forced on the Government which will be both unsatisfactory and dangerous to private enterprise.

II. The problem with which this report is concerned is that of long-term and equity capital and not that of short-term capital. Commercial bank credit should not be considered as a source of permanent capital for business. Such distortion of the proper function of bank credit would be certain to produce disastrous results for the borrowers, for the lenders, and for the national economy as a whole.

III. Capital issues in amounts of less than \$100,000 cover the overwhelming proportion of the needs for outside capital on the part of small business under any reasonable definition of the latter term.

IV. As a general rule, the existing investment banking machinery does not, and cannot be expected to, handle capital issues in such small amounts. No other institutional machinery is now in existence to fill this gap.

V. The growing weight of Federal taxation on business has made it exceedingly difficult for small enterprises to provide for their capital requirements out of accumulated earnings. At the same time, the extremely heavy burdens of personal income and estate taxation have made wealthy individuals very reluctant to invest in the securities of small and risky businesses.

VI. Although prompt and drastic revision of the Federal tax system after the war is essential for American business, both small and large, we doubt that such changes will come soon enough to meet the needs of small business, and we fear that tax reform alone may not be adequate.

VII. Any satisfactory solution of this problem must be predicated upon the following basic facts:

(a) Capital for small business is essentially risk capital, regardless of the form it may take. The providers of such capital, therefore, must be given returns commensurate with the risks incurred.

(b) The success of any small business depends almost wholly upon the managerial ability of one or two individuals. An accurate evaluation of such managerial ability can only be made by direct and personal acquaintance with the individuals concerned.

VIII. No centralized national authority, however competent, can properly handle this problem. Most unsuited of all is the Federal

Government, because, by its very nature as a political organization, it cannot discriminate objectively among management risks.

IX. We are strongly opposed to any schemes which would attempt to solve this problem after the war by means of direct Government loans, Government guaranties, or insurance plans based upon Government credit. We are convinced that all such schemes are not only unworkable but also would constitute a major threat to the system of private enterprise in the United States.

X. The situation calls for the creation of new institutional machinery in the form of a system of decentralized investment funds under the management of local businessmen, who are the only persons well qualified to evaluate the merits of small local enterprises.

XI. The generally unsatisfactory record of community investment funds in the past presents serious obstacles to any attempt to establish by voluntary action a Nation-wide system of this kind with sufficient speed and with sufficient scope to meet the emergency. To overcome these obstacles, the proposed system will require national legislation to stimulate prompt and effective local action.

#### RECOMMENDATIONS

As one logical way of attaining this objective, we propose the enactment of Federal legislation which would authorize the establishment under private management of local investment companies to provide capital for small business in accordance with the following terms:

I. The Board of Governors of the Federal Reserve System would be given authority to grant charters to investment companies to operate within any one of the several Federal Reserve districts. Charters would be granted only upon applications made through the Federal Reserve bank of the district in which the investment company proposed to operate. Each such company would be required to have not less than \$25,000 of subscribed and paid-in capital, and each Federal Reserve bank would investigate and report to the Board the qualifications of the board of directors and management of the proposed company and the need for such a fund in the territory in which the company proposed to operate.

II. A chartered investment company would be authorized to purchase for investment or resale mortgage bonds, debentures, preferred and common stocks of corporations located within the Federal Reserve district, and to make loans to unincorporated businesses. The amount of such loans made to, or securities purchased at any one time from, a single issuer would be limited to \$100,000.

We think that limitation is important in order to make it clear that this is for the financing of small business and not for the financing of large business.

III. The Federal Reserve bank of the district in which an investment company is chartered would be obligated to purchase at any time within 5 years thereafter debentures of the company up to an amount equal to three times its paid-in capital. For example, a chartered company with \$250,000 of paid-in capital could sell \$750,000 of its debentures to the Federal Reserve bank, thus giving the company \$1,000,000 of funds with which to operate.

No Federal Reserve bank would be required to purchase such debentures if the aggregate of such Federal Reserve bank's purchases equaled or exceeded the amount originally advanced by it for stock of the Federal Deposit Insurance Corporation. Funds heretofore paid to the several Federal Reserve banks by the Secretary of the Treasury under the provisions of section 13B of the Federal Reserve Act would be returned to the Secretary of the Treasury. These, together with the funds now held by the Secretary of the Treasury and carried on the books of the Treasury under the title "Payments to Federal Reserve Banks for Industrial Loans—Section 13B, Federal Reserve Act, as Amended," would be made available for the purchase of debentures upon the order of the Board as and when charters were granted. All stock of the Federal Deposit Insurance Corporation would be transferred to the United States and the existing provisions of section 13B of the Federal Reserve Act would be repealed. In this manner, funds aggregating approximately \$139,000,000 would be made available to the Federal Reserve banks for the purchase of debentures.

I want to stop briefly to point out that this procedure is proposed—I know it has been proposed in other bills such as the Wagner-Spence bill—as a way of making a substantial sum of money available for capital to small business without the necessity of a special appropriation by the Congress.

Now, we do not say that this would be adequate to the task. We frankly don't know. We certainly believe that it would be a very substantial sum that can be made easily available to the Federal Reserve banks for this purpose. I think if the funds were entirely used, it would then be up to the Congress to reexamine the matter and see whether additional funds are needed. [Continuing:]

IV. The debentures would mature in 25 years and would carry an interest rate fixed at some moderate differential above the Federal Reserve rediscount rate. As long as any debentures were outstanding, the investment company could not incur any other indebtedness except that secured by the pledge of United States Government obligations.

Each Federal Reserve bank would be authorized to make periodic examinations of the books of account of the investment companies chartered within its district as long as it held debentures of such companies.

I would ask you to follow carefully the next point, because I think it is really the heart of this proposal. [Continuing:]

V. The capital stock of the investment company would be divided into two classes: Class A shares and class B shares. The class A shares would be issued to the subscribers of the paid-in capital of the company.

That is the local businessmen that put up the original equity capital for the company. [Continuing:]

The class B shares would be issued, in accordance with the terms set forth in section VI below, to the business concerns which obtained capital funds from the investment company.

I would like to point out that we have followed the pattern that was established in setting up the Federal Land banks. [Continuing:]



Both classes of capital stock would be entitled to receive dividends at the same rate out of net earnings from operations. Thus, if at any time the company declared a dividend on the class A shares it would be required to declare a dividend on the class B shares at the same rate.

The company would have the right, however, to use all or any part of its net earnings not paid out in dividends to redeem class B shares at their par value and to purchase such shares in the market at prices not in excess of par. If at any time the company had no class B shares outstanding, all net earnings would be available for the payment of dividends on the class A shares without restriction as to rate.

In liquidation, the class A shares would be paid off first at their full par value. Assets available after provision for the retirement of Class A shares would then be used to pay off the class B shares up to their full par value. Any excess assets beyond this amount would accrue to class A shareholders.

VI. Whenever a loan was made or securities purchased, the investment company could require the borrowing or issuing company to employ up to 10 percent of the cash proceeds of the transaction in the purchase of class B shares. In other words, a business enterprise which sold \$50,000 of its preferred or common stock to the investment company could be required to purchase up to \$5,000 of the investment company's class B shares. The actual amount of shares so purchased, within the 10 percent limitation, would depend upon the investment company's evaluation of the risk, and also upon bargaining between the two parties.

By this cooperative device the issuing company, the company that borrowed the money or sold its securities would in effect be paying an insurance premium to cover the risk of the transaction. In return for this payment it would be entitled to a participation in the earnings of the investment company and an eventual return of its investment as a whole or in part to the extent that losses incurred in the business did not eliminate the equity of the class B shareholders. On the other hand, the issuance of class B shares would provide a cushion against future losses to protect the invested capital of the class A shareholders.

VII. Small businesses usually have a need for expert management advice and other technical assistance at least equal to their actual need for capital. The investment companies, therefore, should be authorized to render such services to their business clients and to charge moderate fees for such services. A great opportunity exists for raising the level of small business management, and the cost of such expert assistance should be borne by those that benefit therefrom.

VIII. The charter should probably include the following miscellaneous provisions:

(a) Directors should serve without compensation.

That has been questioned to me by many people. However, our committee all agreed that the directors should approach this thing as a matter of public service and they should be asked to serve without compensation.

(b) Compensation paid to the permanent staff of the investment company should be adequate to attract superior ability, but should be subject to the approval of the Federal Reserve bank.

Although not suggested as a charter provision, we believe that the managements of the proposed investment companies should make

every effort to employ their capital as revolving funds rather than for permanent holding of the securities purchased. In other words, as soon as an issue has matured enough for refinancing or disposal to the public, the investment company should endeavor to sell it to permanent investors and thus release its capital for further operations.

IX. We believe that the plan outlined above would provide ample incentive for prompt and effective action in communities all over the country. On the one hand, the local investment companies would have the right to borrow on attractive terms from their Federal Reserve bank and would have considerable protection against losses by the cushion created through the issuance of class B shares. These two features should make the establishment of such investment companies a reasonably sound business proposition, although we believe that civic pride in the communities will furnish a greater driving force than the profit possibilities.

On the other hand, the device of class B shares should give assurance to small businessmen that their capital issues will not be loaded with excessive costs. First, they will participate equitably in any excess earnings of the investment company, and second, they will have an opportunity to recover part or all of their investment insofar as the loss experience of the investment company proves satisfactory.

#### THE SETTING OF THE PROBLEM

The problems of small business in the United States have become a matter of major concern during the past few years. Almost universal agreement exists that the health of small-scale enterprise—the opportunity for every American to establish his own business and the maintenance of economic conditions which will permit such businesses to grow and prosper—is essential to the preservation of our free society. The objective is easy to state, but finding the proper answers to some of the questions is a very different matter.

In the forefront of small business problems today is the question of how best to assure a steady and adequate flow of long-term and equity capital to small business enterprise. The importance of this problem for the national economy is shown clearly by a few simple statistics. Thus, we know that there are approximately 2,000,000 business employers in the United States. Of these 2,000,000 separate business establishments, only about 3,300 employ more than 1,000 workers each; some 35,000 employ from 100 to 1,000; while the balance of about 1,950,000 employ less than 100 workers each. This last group of relatively small businesses accounts in the aggregate for about 45 percent of the total business employment in the United States.

This report is concerned solely with the problem of long-term and permanent capital for small business, and not with that of short-term credit. Much confusion exists in the public mind today as to the difference between permanent capital and bank credit, and there is serious danger that undue pressure may be exerted upon the commercial banks to provide permanent capital for small business instead of restricting themselves to legitimate short-term and intermediate credit needs. Such a distortion of the proper functions of bank credit would be certain to produce disastrous results for the borrowers, for the lenders, and for the national economy as a whole.

We are convinced that the basic financial problem of small business is that of permanent capital rather than that of short-term credit. An ample supply of credit is available for businesses which have adequate capital, but it is very difficult for a bank to extend credit to a business with inadequate permanent capital.

In order to simplify our analysis we have deliberately limited our study to the field of capital issues in amounts of less than \$100,000. Although admittedly a somewhat arbitrary dividing line, this figure does seem to be generally in accord with the economic facts. It is clear that very few of the nearly 2,000,000 small business employers have capital requirements in excess of \$100,000. Moreover, larger capital issues of businesses with reasonably satisfactory records and promising futures can usually find a market through the established investment banking channels. We may safely conclude, therefore, that the problem of capital for small business and for most new businesses is that of finding satisfactory outlets for security issues of less than \$100,000.

#### THE FOG SURROUNDING THE PROBLEM

A major obstacle to any analysis of the capital needs of small business is the inadequacy of the available statistical data. Although many volumes have been written on the subject, and reams of congressional testimony taken, very little concrete evidence exists as to whether or not small business is suffering from a shortage of capital. The available evidence is both inconclusive and contradictory. For example, a recent survey has been made by the National Industrial Conference Board of working capital ratios of 125 small and large businesses. This analysis showed somewhat alarmingly low working capital ratios for the small businesses studied in relation to those of the larger units. On the other hand, Dr. A. D. H. Kaplan, of the Committee for Economic Development, recently conducted a field investigation of several hundred firms to determine how small business managements feel about their own capital needs. He reports a very negative response, very few of the businessmen interviewed being willing to admit that they have any serious capital problems. Dr. Kaplan agrees, however, that these answers cannot be taken too seriously because the absence of capital needs under wartime conditions is not necessarily relevant to what the situation may be when our economy is faced with the problems of converting to peacetime conditions of demand and supply.

Another important difficulty arises from the political prominence now given to the plight of small business. Except, perhaps, for the war veteran, the small businessman is providing the most popular political slogan of the day. Much of this agitation undoubtedly arises from a sincere belief in the vital importance of small business for the preservation of our private enterprise system, but much of it is clearly spurious. On the one hand, we are witnessing the inevitable tendency of an entrenched bureaucracy to perpetuate itself in the efforts of the smaller war plants organization to continue after the war as a permanent peacetime institution. On the other hand, there is evidence that some, who do not really believe in private enterprise, are attempting to use this opportunity to drive a permanent wedge



between small and large business and thus make easier the transition to a centrally planned economy.

In the absence of positive statistical evidence, and in the face of such political pressures, the easiest course for a business group would be to oppose action of any kind. Such a negative attitude, however, would be extremely short-sighted and stupid. Despite the absence of statistical proof, we are convinced by the logic of the situation that the capital needs of small business will present a real and serious problem after the war. Moreover, we are convinced that, unless business leadership can offer a constructive solution to this problem, some solution will be forced on the Government which will be both unsatisfactory and dangerous to private enterprise.

I want to point out that the next section sets forth why we are convinced that this financing of small business just does not fit into existing machinery of the investment banking business. Investment banking business is set up to handle on a national and international scale securities on a wholesale basis and for reasons that I think are made clear in there, it is just exceedingly difficult and costly for an investment banker to handle as small an issue as \$50,000.

We point out also the effect of growing taxation in making it exceedingly difficult for a small business to build up capital from its own earnings.

We point out the increasing difficulty brought about from taxation and as a result of social change. I want to make the point, Mr. Chairman, because I think it is not often made, as to why a wealthy individual is not willing to invest in a small business. Certainly taxes are very important, but the very growth of our large metropolitan cities is very important where no longer does the substantial capitalist have an acquaintance with the little businessman around the corner. It is much easier for him to turn to the established national market, the New York Stock Exchange, and say, "I just haven't the time and energy to study the business around the corner."

Now, therefore, we reach the conclusion that we are going to need this new institutional machinery that I have outlined before. We then cover in this report some suggested solutions. [Continuing:]

#### THE LOGIC OF THE PROBLEM

I. It is evident that no private institutional machinery exists for marketing capital issues of less than \$100,000. Investment bankers, except in unusual cases, rarely find it practicable to underwrite issues of such small amounts. There are several reasons for this, most of which are not well understood by the general public. They may be summarized briefly as follows:

(a) Investment bankers as such are not investors, but are merchants of securities. Thus, they do not purchase new security issues to hold, but to resell as promptly as possible to others. An important consideration, therefore, is the ready marketability of the issue. Small issues, particularly those of little-known business concerns, have very limited markets and afford considerable risk and difficulty to the underwriter, both in the initial sale to the public and in the maintenance afterwards of satisfactory markets.



(b) Few outsiders realize that an underwriter, in offering a security issue to the public, accepts a responsibility for the soundness of the issue for as long as it remains outstanding. A few issues which turn sour will very quickly ruin the business of an investment banker. From bitter experience investment bankers have learned that the risk factor in securities tends to vary in inverse ratio with the size of the issue. In other words, the smaller the issue and the business of the issuer the greater is the likelihood of failure.

The basic reason for this is the problem of management. Many large businesses, because of great capital resources or strategic economic positions, may survive through years of inferior management. There are very few small businesses, however, that do not depend for their success or failure almost wholly upon the energy and intelligence of the one or two individuals who constitute the management.

(c) The cost to an underwriter of preparing and handling a new issue is usually much the same, whether the issue is large or small. As a percentage of the total amount of an issue, this cost becomes, therefore, many times greater in the case of a \$50,000 issue than in the case of a \$5,000,000 issue.

The above combination of circumstances makes it exceedingly difficult for investment bankers to underwrite and sell to the public issues in amounts as small as those we are considering here. The small businessmen, on the other hand, usually cannot afford to pay the proper costs of such financing.

The basic fact is that practically all capital issues in amounts of less than \$100,000 represent genuine risk capital from the standpoint of the underwriter and investor, regardless of whether the issue takes the form of a first-mortgage bond or a common stock. The difference is one of degree and not of kind. Until this fact is clearly understood, there can be little hope of finding a satisfactory solution of the problem of capital for small business.

II. In the past, American small business has obtained its capital requirements from two principal sources:

(a) The retention of plowing back of earnings in the business, and

(b) Outside capital from relatives or friends who are intimately acquainted with the small entrepreneur.

Until recent years, the vigorous growth of small business in the United States has been in itself concrete proof that this hit-or-miss system has worked reasonably well. For example, a recent survey in the city of Worcester, Mass., revealed that every single one of the successful enterprises in that community had started with an initial capital of less than \$50,000.

During the past decade, however, conditions have arisen which make it extremely doubtful that the usual sources of capital for small business can be relied upon to meet the need. Foremost among the reasons for this change has been the steadily increasing impact of Federal taxation. The growing weight of taxes on business enterprise has made it more and more difficult for small businesses to expand from retained earnings. On the other hand, the extremely high rates for personal income and estate taxation have made wealthy individuals more and more reluctant to invest in small and risky enterprises.

Instead, they have been driven to seek safety and liquidity in the securities of large and seasoned corporations and in the bonds of governmental agencies. Without implying any criticism of the wartime tax structure as a necessity of war, we must point out that a drastic revision of the present tax system as soon as peace comes will be essential if small and new enterprises are to obtain the capital they will need for expansion.

It should be clear to anyone that, even with corporate tax rates only one-half as high as at present, the Ford Motor Co. would never have been able to grow from its humble beginnings to the giant enterprise it became during the first quarter of this century.

Another factor which has increased the difficulties of the small businessman in obtaining capital from outsiders has been the growth in the size of our cities. In our large metropolitan communities the individual with money to invest is not likely to have the close personal acquaintance with small businessmen that he would have in a small town. Lacking this personal relationship, he finds it much easier to invest in securities listed on the New York Stock Exchange and other large issues of national reputation.

From the above analysis we reach the following conclusions:

(a) The investment banking mechanism is not equipped to take care of the capital needs of small business and cannot be expected to do so.

(b) The sources, both internal and external, which formerly supplied the great bulk of small business capital have largely dried up under the withering effect of Federal taxation and the influence of social change.

(c) This serious situation is presently obscured by the blanket of a wartime economy. It will come to light, and may confront us with a crisis, when small business is faced with the problems of the change-over to a normal peacetime economy.

(d) Private enterprise must find a constructive and realistic solution of this problem, or else accept the inevitable result that Government credit will be used to fill the existing void.

We turn now to a consideration of some of the alternative suggestions which have been offered as solutions of this problem.

#### SOME SUGGESTED SOLUTIONS

##### *1. Direct Government loans or Government securities*

It is an axiom of sound finance that the heart of the credit problem is discrimination among individual risks. By no means all businessmen are deserving of credit and capital. They must prove this right by demonstrating character and business ability. Such discrimination is the proper function of commercial and investment bankers in their respective fields.

By its very nature a governmental body is unsuited to exercise such discrimination. It is under compulsion to treat all of its citizens alike, as in its provision of postal service or other common carrier service. Insofar as it exercises discrimination such action is almost certain to be based upon political consideration rather than upon business judgment. Moreover, a political lending body makes a record chiefly by its activity in extending credit rather than by its judicious restraint.

I should like to make this clear. I am not talking in opposition to reconversion loans, to loans that are a part of the war period that are being handled today by Government agencies and by the Smaller Plants Corporation for the reconversion of business back to peacetime level of activity or peacetime status.

What we are talking about is permanent machinery after that period, and we express and give the reasons for our opposition and belief why direct Government loans or Government guaranties are not suitable for handling this problem of long-term capital for small business. [Continuing:]

Exceptions to the above generalizations may be noted in the following instances:

(a) Where Government credit is extended on the basis of some simple, standard form of asset, and where the human equation is reduced to a minimum. Such cases of successful Government lending are found in the Federal farm mortgages and the Federal home mortgages. In both instances the right to the loan depends upon the possession of standardized types of real estate and very little upon the character and business ability of the borrower.

(b) During periods of business crisis when all values are severally depressed and private credit mechanisms are not functioning. It was a situation of this kind that led to the creation of the Reconstruction Finance Corporation, and was responsible in large measure for its successful operations.

(c) In time of war when Government credit is extended to businesses holding contracts to supply the Government with needed war goods. In this case the safety of the loan depends primarily upon the war contract and only secondarily upon the character and ability of the borrower.

Government guaranty of private credit is one step removed from direct Government lending and, therefore, is preferable to the latter. It involves the use of private agencies and a small share in the risk by such agencies. Nevertheless, it is unsound because it would require the governmental body to examine and pass judgment upon each loan application, which a political body is not qualified to do.

Moreover, it would demoralize our commercial banking system, partly by taking over risks which should be assumed by the banks themselves, and partly by forcing the banks into loans which are outside their proper sphere.

The wartime experience with direct Government loans or indirect guaranties furnishes no satisfactory criterion for the postwar period. As pointed out above, the essence of success in small business is management, and no governmental agency, especially a national body located in Washington, can possibly evaluate the management risk in the capital issue of a small business enterprise in Kalamazoo, Mich. Small business is characterized by its diversity, and no single formula could be devised to cover all possible cases.

We are strongly opposed, therefore, to the provision of capital or credit for small business after the war by direct Government loans or guaranties. We should regard such a step as a threat of major proportions to the preservation of private enterprise in this country. If we are driven to such expedients by the failure of business to provide its own solution, we should recognize them as spelling the doom of our free society.



## *II. Credit insurance schemes*

A widespread notion prevails that there is some kind of magic in the pooling of credits or in similar schemes. By such devices it is hoped to eliminate the risks in small business financing and thus make possible the handling of such credits at a minimum cost to the borrowers.

Diversification of risks is, of course, a fundamental principle of sound finance. Successful diversification assumes, however, that the yield on the good investments will be more than sufficient to offset the losses on those which fail. Thus, unless there is a prospect for more than ordinary returns, little is gained by diversification. The same general principle applies to all insurance plans. Unless the premiums charged are sufficient to cover all losses incurred, such schemes are bound to fail.

In either event, the sound credits will be forced to bear the cost of the losses incurred on the unsound risks. This seems to us not only unsound but also inequitable. Each credit risk should be judged separately on its own merits and charged accordingly. Once this is done, as is proposed in our plan for local investment companies, there is merit to the diversification of the risks assumed. In the absence of such credit analysis by those qualified to do so, we can see little merit to any schemes for the pooling of risks or the insurance of risks. Another reason for our opposition to such plans is that most of them would involve some form of concealed governmental subsidy or the use of Government credit.

## *III. Federal tax revision*

Many businessmen are convinced that the problems of small business will be largely solved by prompt and adequate relief after the war from the present heavy burden of Federal taxation. We have already pointed out how current tax rates on business enterprise and on individuals are drying up the normal sources of capital for small business. We have also stated our conviction that a drastic revision of the Federal tax system as soon as possible after the war will be essential for American business, both small and large.

Nevertheless, we fear that adequate tax reform may not come soon enough to meet the postwar emergency of small business. Moreover, we doubt that tax revision by itself will provide a complete answer to the problem. The investing habits of the public, when once established, are not easy to change, and individuals with funds to invest are not likely to return readily to the field of small local investments. Thus, while subscribing to the fundamental importance of postwar tax revision, we feel the situation requires positive action in other areas.

There are, however, certain tax reforms which could be effected almost immediately after the end of hostilities, and which would provide substantial relief for small business. With this objective in view, and without prejudice to the broader task of over-all revision of the Federal tax structure, we recommend the following specific changes:

(a) Prompt elimination of the wartime excess profits tax. This levy on corporate earnings falls with particular severity on small and new businesses which have neither satisfactory past earnings records nor adequate capital bases. As such, it would provide an over-

whelming handicap to venture capital for small business in times of peace.

(b) Downward revision of the lower bracket tax rates for corporate net income. At present, corporate income tax rates start at a combined figure of 25 percent for the first \$5,000, and rise on a graduated scale until they reach the standard rate of 40 percent for all earnings above \$50,000. In place of this schedule, we believe the following could be adopted with great benefit to small business and without serious detriment to the Federal budget:

Exempt from all taxation the first \$2,000 of all corporate net incomes; tax the next \$8,000 of corporate net income at a rate of not more than 15 percent; apply a graduated upward scale on income over \$10,000 until the full standard rate is reached for income in excess of \$50,000. Since the standard corporate income tax rate after the war must depend upon the size of the Federal budget, as well as upon other considerations, we make no recommendation as to what the rate should be.

(c) Permit both corporate and noncorporate businesses to carry forward losses to apply against subsequent earnings for a period of at least 6 years. The present carry-back and carry-forward provisions of the law are inadequate for many small new businesses which usually sustain losses during the first several years of their existence. Extending the carry-forward provision to 6 years should provide an important stimulus for venture capital to go into new enterprises.

#### MANAGEMENT SERVICE COMPANIES

Some students of small business problems maintain that what small business managements really need is advice and guidance rather than direct access to capital. This school holds that if management service companies are established in each community to render advice and guidance to small business at a moderate cost there will be no real need for the creation of local investment funds. The contention is made that such service companies can direct deserving applicants to existing sources of capital, and by their recommendations provide for the capital requirements of small business.

Undoubtedly there is a great opportunity to raise the general efficiency of small business by rendering advice and assistance. We have already recognized this by recommending that such service be rendered for moderate fees as a regular function of our proposed local investment companies.

We are convinced, however, that management service companies without funds to invest cannot do the job that is called for. Probably they could find capital for outstandingly promising ventures, but it is very doubtful if they could do as much for the rank and file of deserving small businesses which cannot look forward to a spectacular growth. It is usually forgotten that the great bulk of American small businesses are not found in the field of manufacturing, but in the distributive and service trades.

A great many small companies in the latter groups are certainly entitled to capital, but very few of them can offer much in the way of speculative attraction. As a matter of fact, one of the important services needed to be rendered to small businessmen is to teach them

the value of being adequately financed instead of continuing to operate on a shoestring as many of them do.

For these reasons we believe that the service function by itself will not take care of the capital needs of small business, but should be combined with the operations of the proposed local investment companies.

#### LOCAL INVESTMENT COMPANIES

The logic of all our arguments leads to the conclusion that a nationwide system of local investment companies offers the ideal solution to the problem of making long term and equity capital available to small business. The only individuals well qualified to evaluate the risks involved are local businessmen who have direct and personal knowledge of the character and ability of local small business managements.

Moreover, full recognition must be given to the fact that capital for small business cannot be provided without incurring substantial risks, and adequate compensation must be paid to those who assume such risks. Failure to make a proper evaluation of the risks incurred has been the basic reason for the generally unsatisfactory record of most community funds established in the past to finance local small business.

Information is available on some 30 such funds or credit pools which have been established during the past 35 years in various parts of the United States. Unfortunately, most of these were set up as civic promotional ventures in an effort to attract new industries to their respective communities. In their eagerness to achieve this objective, the managers of these funds have usually underestimated the risk factor in financing small business and most of them have been forced out of business by the losses they have suffered.

Because of their promotional character, we do not believe that the record of community funds in the past is a relevant argument as to what may be expected under a proper set-up and with satisfactory management. One outstanding example of what may be accomplished in this field is furnished by the Louisville Industrial Foundation, which has provided capital for the small businesses of Louisville for the past 28 years. During this period the fund earned an aggregate net income of about \$100,000 after deducting all expenses and losses.

To be successful, local investment funds must establish adequate reserves against the almost inevitable losses in this type of financing. How to accomplish this, and still convince small business and the general public that financing costs are not excessive, is the fundamental problem to be solved. We believe that our proposal to issue class B stock of the investment companies to provide a cushion against losses offers a satisfactory solution to the dual problem of how to charge enough to cover the risks incurred and still avoid the danger of charging more than these risks justify.

#### THE ROLE OF THE INVESTMENT BANKER

The proposal has been made that the problem of providing capital for small business can be solved by permitting some governmental agency to invest in the senior securities of the firms now carrying on



an investment banking business. We are strongly opposed to any such plan.

We have already pointed out that investment bankers are merchants of securities and not investors as such. The entire machinery of the investment banking business is geared to the large-scale distribution of securities on a national and international basis. For this, and many other reasons, it is not well adapted to the handling of capital issues of \$100,000 and less.

We are convinced that the main objective cannot be attained if the financing of small business is treated merely as a minor adjunct of investment banking machinery. Instead, we believe that the task should be conceived as a broad community undertaking in which local investment dealers take an active part along with other business and civic leaders.

If our proposals are adopted, we urge investment dealers throughout the United States to participate actively in this movement along the following lines:

1. Assist in the establishment of the local investment companies and in the raising of capital therefor.
2. Make available their experience in judging business risks by serving on the boards of directors of the investment companies.
3. Assist the investment-company managements in finding outlets for their investments which have been seasoned sufficiently to pass on to the public.
4. Keep closely in touch with local enterprises which have capital requirements in excess of \$100,000 and make every effort to see that all legitimate capital needs of this kind are provided for through established investment channels.

The fear has been expressed that the volume of capital in the investment banking business will be inadequate to handle the capital requirements of industry after the war. We see no cause for concern on this score. Although investment banking capital underwent a shrinkage between 1929 and 1940, the total amount is still substantial. Moreover, we are confident that, if there is an active demand for capital after the war, as we believe there will be, and if adequate tax relief is forthcoming, additional capital will flow into investment banking to any extent that is necessary.

It should be clear from the above that the plan proposed in this report has not been conceived in a narrow spirit of special advantage for the investment banking business. It is our conviction that the problem of financing small business transcends the proper sphere of investment banking and should be treated as a problem involving the national economy as a whole.

Investment bankers will benefit from the adoption of our plan only insofar as it is successful in placing our national economy on a sounder basis.

I know it is a pretty technical plan and I hope I haven't left you in a state of confusion as to what I am talking about, but I have covered the high spots as best I could within the time allotted.

The CHAIRMAN. Thank you, Mr. Fennelly. So far as I am concerned, it is a novel plan, a new one, and certainly it is intriguing.

I wonder, Mr. Folsom, if you had some questions that you wanted to ask briefly.



Mr. FOLSOM. Mr. Fennelly has covered quite adequately the questions I had in mind, but there are two or three that I might ask before we get into a discussion of this particular plan he has proposed.

Are you familiar with the report of the committee issued last fall on the economic problems of the reconversion period?

Mr. FENNELLY. Yes.

Mr. FOLSOM. We had 8 or 10 pages on taxes. Are you in general accord with those suggestions?

Mr. FENNELLY. Yes; I am, Mr. Folsom. I would go a little beyond that in these recommendations here, because I still am a little afraid that general tax revision will be too slow in coming. If that plan could be put in effect very quickly, I would have no qualms or questions, but I am still very fearful that, as far as small business is concerned, that the relief proposed may be too slow in coming, and these are proposals that are somewhat different from those just based on that fear. If that goes through, most of these would wash out.

Mr. FOLSOM. You mentioned the handicap of taxes insofar as equity concerned. Do you mean the double taxes on equities and common stocks?

Mr. FENNELLY. Yes, I do. The tax benefit that you get today on debt and that you do not get on equity puts a terrific pressure on a company to finance by way of debt rather than equity and if that continued for long, I think it could give us some very dangerous capital structures.

I think business has been resisting that tendency, but the pressure is on it every day to increase their debt and actually retire equity and increase their debt and it seems to me a highly dangerous situation.

Mr. FOLSOM. Has your committee considered these plans for credit insurance?

Mr. FENNELLY. Yes, we did, Mr. Folsom, and I have a section in here on that. I think they missed the point. There seems to be a notion that if you merely pool a lot of credits, without examining any of them, that the law of averages will make them all work out and that you can afford to charge the lowest rate of interest on the bundle as a whole.

That just isn't so. Diversification is a thoroughly sound financial principle, but it is predicated on the notion that you will get more than an average return on good investments to compensate for the bad investments, and unless you do there is no credit-insurance scheme that will work, and we think that every credit must be analyzed and judged by those that are competent to do so, and those that are competent to do so in the case of small business are the ones that know the management and its ability and character, and we believe that basically this thing must be handled by a decentralized program.

Mr. FOLSOM. You mentioned in your statement that there had been experience in some communities with the local investment and development companies. I know several cities that have tried them. Not many of them worked out successfully.

Why do you think this particular plan will work out better than those other plans?

Mr. FENNELLY. I would turn the question, if I might, the other way around. As I see it, the chief reason why most of the funds

have failed is because they have started out as promotional funds to bring industries to a new community, as a community expansion plan, and in their enthusiasm for doing so, they have generally underestimated the risk involved and advanced money to new business enterprises to bring them to the community on a basis that they had no justification for doing.

There is one outstanding example of success in this field that we have studied very carefully. That is the Louisville Foundation, where they have handled their credits and their advancing of capital on a sound basis. We think that they have tended to emphasize debt rather than equity capital more than is desirable, and I think they will agree that, if they had taken this plan of ours and applied it by making the borrower or the seller of stock, subscribe to our proposed class B stock, their record would have been eminently satisfactory over the 28-year period in which they have operated.

I have illusions about this thing. There is risk, and there are going to be losses taken and I would expect that quite a number of these companies would go under, but I would like to point out to the committee that the people who will lose the money first will be the people that put up the equity money for the company.

Mr. VOORHIS. No; the people that will lose first are the businesses that borrow it.

Mr. FENNELLY. No—well, yes, if their business fails, Mr. Voorhis, they will lose the money.

Mr. VOORHIS. The class B stockholders will be the first ones.

Mr. FENNELLY. The class B stockholders is treated in our eyes as a form of premium for credit risk, but a cooperative scheme that will return to the subscribers of that capital their premium that they put up for this thing insofar as the company does not incur losses.

Mr. VOORHIS. I just wanted to take exception to that one point.

Mr. FENNELLY. I see what you mean. I wouldn't attempt to argue the point. The capital in the company is local investment capital, and it would be lost before any of the Federal Reserve credit would be lost.

Mr. VOORHIS. That's right.

Mr. FOLSOM. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Murdock.

Mr. MURDOCK. Yes, Mr. Chairman; the witness has indicated that tax reform is one of the crying needs. I would like to ask whether the CED has given study specifically to tax reform as applied to the mining industry.

Mr. FENNELLY. No; they haven't, Mr. Murdock. I can assure you that the CED has avoided getting into any special industry problem and all their tax studies have attempted to approach the problem on an over-all national basis. We felt that there are so many special problems of this kind that we would be lost in the forest if we attempted to tackle them.

Mr. MURDOCK. The mining situation is peculiar, of course, and the mining people are feeling that they have tax problems that are not exactly akin to the others. I am searching for help in that respect.

Mr. FENNELLY. I am just afraid that I am not competent to suggest anything, Mr. Murdock.

Mr. MURDOCK. I would like to get a suggestion from anyone.

Mr. FENNELLY. Right, if I can find anybody that has been working on it, I will see what I can do.

The CHAIRMAN. Mr. Gifford.

Mr. GIFFORD. I would like to say that the \$100,000 limitation would seem to be an attempt not to enter your field of investment banking.

Mr. FENNELLY. That was not our idea at all.

Mr. GIFFORD. You wouldn't handle any of this \$100,000 business?

Mr. FENNELLY. Well, I think that we hope that the local investment dealers, when issues that have been bought by the investment company have matured and are of a nature that could be properly passed on to the public, that they will work with the investment company in placing those securities.

Mr. GIFFORD. You think the prejudices of local businessmen who would run this company, without pay, would be against or for the local men who are trying to do business?

Mr. FENNELLY. I think they would be decidedly prejudicial in their favor.

Mr. GIFFORD. Did you have any experience with the Federal land bank when they appointed men in the locality to determine whether people were competent to get a loan?

Mr. FENNELLY. No, sir; I haven't.

Mr. GIFFORD. I think that was a sorry experience. Those local men who determined whether they were entitled to loans didn't think that very many farmers were competent to get a loan. I think it ought to be otherwise.

Mr. FENNELLY. I think there are bound to be a great variety of differences. I am sure that you won't get universally high performance under any plan of this kind.

Mr. FOLSOM. You will have a check from the Federal Reserve.

Mr. FENNELLY. Yes; with the local Federal Reserve bank, who we propose be given the authority to recommend a charter on the basis of the qualifications of the group of individuals that are set up as directors of this company.

Mr. GIFFORD. You think the Federal Government would be required to authorize by law this voluntary organization, the investment fund? You think that is necessary, or do you do it because you want to involve the Federal Reserve?

Mr. FENNELLY. I don't do it because I want to involve the Federal Reserve; but I think this—if you are going to get these local investment companies started on a broad enough scale and fast enough, that you need the stimulus of Federal legislation which would provide an impetus and a push to get them started.

It does seem to me evident that in some cases local investment companies will spring up and can spring up without Federal aid, but I don't believe the job would be done rapidly enough.

Mr. GIFFORD. You think it would involve the Federal Reserve bank; and if it does that, they wouldn't make a lot of rules and regulations before they would invest? You are familiar with the different regulations now that bankers and businessmen are subjected to?

Mr. FENNELLY. Yes; but I don't think that a local company, unless it wants the help and support of the Federal Reserve bank and put through an agreement to purchase debentures of the company, need



go to the Federal Reserve bank at all. But we would like to hold it out to them as a way of getting the pools of money started.

Mr. GIFFORD. Where do you think this \$100,000 would come from in the first instance—local business?

Mr. FENNELLY. Yes.

Mr. GIFFORD. Wouldn't it be a fund open for investors?

Mr. FENNELLY. It would be; yes; but I meant local businessmen. Let's say local citizens. I would make the statement as broad as that.

Mr. GIFFORD. Yes. Of course, I am interested in the regulations imposed by the Federal Reserve bank which prohibit my neighbor or storekeeper from extending credit for more than 2 months. Did you ever hear of that?

Mr. FENNELLY. Beg your pardon?

Mr. GIFFORD. They have regulations where businessmen can't extend credit to customers for more than 2 months.

Mr. FENNELLY. Under wartime regulations.

Mr. GIFFORD. I don't know whether it is wholly wartime.

Mr. FENNELLY. I assumed that it was wartime.

Mr. GIFFORD. I have heard everything put on "wartime." I want to portray to you, Mr. Chairman, the businessman of my community. He will need a little more than a hundred thousand dollars. He has a large furniture store. He does a big business. The Government deprived him of his young men. When I saw him, he was a highly overworked individual. Quite an establishment. Wealthy people were his principal customers, and the poor man looked at me and said: "I haven't been able to make out a bill for 2 months, and when I make them out I have to go to the houses and look them over with very great care; but the Federal Reserve regulations say I can't sell them another thing until I collect, and I can't make out the bills."

Mr. FENNELLY. Might I make a point on the \$100,000?

Mr. GIFFORD. Go ahead. I was hoping you could relieve this customer of mine.

Mr. FENNELLY. As far as I am concerned, as far as the I. B. A. is concerned, I know we have no objections whatsoever to increasing the amount to above \$100,000 to any reasonable amount that would seem appropriate, and I assure you that the last thing in our minds was keeping this plan out of competition with the investment banking machinery.

What we were afraid of was this: If these funds were set up and were permitted to make advances of, let's say, half a million or a million dollars, the funds of that company would be quickly used up in those larger-scale enterprises which are much easier to lend to, and the funds would not be available, and there would not be the eagerness to make capital available, to the small businesses of this country.

Mr. GIFFORD. I want to pursue the subject of the Federal Reserve dissertation. You deal with the Government. While we as Congressmen might give you the privilege under the law, we cannot foresee and forestall all sorts of regulatory conditions that are written into it, and the first thing we know we are surprised at the results of these things.

The man I mentioned is a splendid citizen, but he couldn't sell those people anything more until he had collected for the merchandise sold during those 60 days, but I suppose the banker would be willing to



carry him along. He might run some risk. I asked at the hearing of the Federal Reserve people what they would do to that man if they discovered he was not collecting those bills within 60 days.

They said they wouldn't do anything to him, but they wouldn't write a letter to me saying they would not. They would not do that.

We country bankers have confidence in each other. We don't ask you to write a mortgage when your credit is good; but the point I am bringing out is that if I had anything to do with the legislation at this time, it would not be the Federal Reserve that should arbitrarily or for any other reason try to tell people how they should run their business.

Think of telling you that you couldn't extend a customer credit after 2 months—a wealthy customer. Why should they bother?

I think I know the answer, but I don't like to give the answer.

Mr. FENNELLY. I sympathize strongly with what you say. I don't think that the investment bankers as a group should be accused of being overly favorable to Government regulation. We have learned an awful lot about Government regulation in our business.

Mr. GIFFORD. We have learned a lot, and my people have learned that the Government isn't their Congressman but some bureaucrat, but they complain to their Congressman and hold him liable. [Laughter.] They hold him liable; so that we, in turn, must hold somebody else.

I didn't mean to charge you as an investment banker with trying to limit your field, but I suppose that naturally we would think that you ought to look after your own business pretty well.

Of course, I am interested in your purchase of stock, which is an insurance—you might call it—to take out losses. The Government has done that pretty well. When you borrow from the Government—I think the Federal land bank, the businessman has to subscribe to class B stock, which is a way of insuring it.

An efficient businessman who subscribes to stock doesn't like to see an inefficient man use up that money that he had provided. You must weight that.

Mr. FENNELLY. I agree.

Mr. GIFFORD. I think Mr. Folsom asked you if you had considered some of the insurance methods, and I enjoyed hearing you say that you wanted to keep the Government out of direct loaning; but is it keeping the Government out of direct loaning when a Federal Reserve bank puts up the money?

Mr. FENNELLY. The Federal Reserve bank would put up money for a local company that would be managed by the individuals that put up the equity money.

Mr. GIFFORD. Managed under conditions imposed by the Federal Reserve bank.

Mr. FENNELLY. That's right.

Mr. GIFFORD. There are some of us on the committee that differ a good deal about the Federal Reserve bank being a straight governmental agency or an independent agency. Can you tell us which it is?

Mr. FENNELLY. That is a very difficult question for me to answer. I think Mr. Draper could probably answer that a lot better than I

could. I know it is not officially a Government agency. I think I am correct in saying that the Board is, but I would prefer to pass that question to somebody that is a lot more familiar and competent than I.

Mr. GIFFORD. You know there is little attempt made that we buy stock in the Federal Reserve bank? Isn't that right?

Mr. VOORHIS. I have heard of that.

Mr. GIFFORD. You have advocated that?

Mr. VOORHIS. Yes; I think I have.

Mr. GIFFORD. Then the Government would operate it, wouldn't they?

Mr. FENNELLY. I suppose so; I don't know.

Mr. GIFFORD. Don't they virtually control it now? This Federal Reserve bank has such a power, and they have been using it in such little matters. You don't buy on the installment plan because you don't have to. Suppose you wanted to.

Mr. FENNELLY. That is a wartime regulation.

Mr. GIFFORD. Can the small businessman buy a bicycle now on the installment plan?

Mr. FENNELLY. I think it is highly desirable that he be not permitted to do so during the war period.

Mr. GIFFORD. Because of the war. He needs the bicycle to get to work just as much now. I agree there is a strong reason, but you can carry it too far and make it utterly ridiculous.

Mr. FENNELLY. I am sure that there are always bound to be sufferers, innocent victims of any blanket decree, and we have seen that many times.

Mr. GIFFORD. I can see where a general rule could be applied, but they should not hide behind that rule and fail to recognize any reasonable exceptions.

I don't want to take too much time, Mr. Chairman, but I have been through this. I know what the small businessman has to endure to try to get money, from local prejudice to Government interference and control.

The CHAIRMAN. If I might suggest, I think there is no difference between you and Mr. Fennelly on the normal regulation, the undesirability of these regulations; but Mr. Fennelly, if I understand him, is talking about the postwar period, and you are directing yourself to the regulations that were thought desirable during the war period.

Mr. GIFFORD. You don't object to my feeling that during the war there are some foolish regulations?

The CHAIRMAN. I don't object to any of your questions, sir. They are always illuminating.

Mr. GIFFORD. I am going to close by saying that I agree with you in your idea that the Government shouldn't do any direct—either directly or by guaranties. Get the Government out of this thing.

Mr. FENNELLY. That is correct, sir. We will.

The CHAIRMAN. I would like also to say that I am certainly, as the gentleman knows, in accord with his views on that subject.

Mr. GIFFORD. A lot of us are, but we don't vote that way.

The CHAIRMAN. I think I vote that way.

Mr. GIFFORD. They make speeches on the floor of Congress, and when they come to voting they don't vote that way.

The CHAIRMAN. Mr. Welch.

Mr. WELCH. What is the present rate of interest charged by the Federal Reserve bank?

Mr. FENNELLY. Mr. Welch, I blush that I do not know exactly what the rediscount rate is today. I wonder if I could be enlightened.

A VOICE. One-half of 1 percent.

Mr. FENNELLY. Half of 1 percent.

What we had in mind there was not to be too specific at this stage of the game as to what the interest rate should be on those debentures. We felt that we should wait and see how the postwar picture unfolded, as to what the normal rediscount rate of the Federal Reserve bank should be. We were thinking about a rate for debentures of somewhat near the rate of long-term Governments, two to two and a half percent.

Mr. WELCH. Following the statement made by Congressman Gifford that they pay as high as 5 percent in his community on loans—

Mr. GIFFORD. I am paying my bank five and a half. What are you talking about—what kind of loan?

Mr. WELCH. Loans from the Federal Reserve bank.

Mr. GIFFORD. Four and a half.

Mr. WELCH. Well, Mr. Fennelly—

Mr. FENNELLY. Mr. Welch, might I make this clear that in talking about that rate I was talking about the rate that the investment company would pay on the debentures that it sold to the Reserve bank.

Mr. WELCH. I am referring to the interest charged.

Mr. FENNELLY. To the individual borrower?

Mr. WELCH. Yes.

Mr. FENNELLY. I don't see how it is possible to set any arbitrary scale on that, because it will vary so with the different kinds of business that want the capital. This small-business financing is bound to be risk financing, and unless an interest rate is charged that is generally commensurate with that risk, you haven't got a chance of doing it.

Mr. WELCH. Charging a high rate of interest would make it all the more insecure.

Mr. FENNELLY. Don't forget that we are not only talking about loans; we are talking about preferred and common stock. We are talking about equity capital, Mr. Welch, and we didn't see how it was possible to set any one standard pattern for all types of capital provided.

Mr. WELCH. I am prompted to ask the question by reason of the fact that high rates of interest were charged, such as were referred to by Congressman Gifford, whereas on the other hand the Dutch recently negotiated a loan of \$100,000,000 from a group of New York bankers at 1½ percent rate of interest to build postwar ships in this country.

Mr. FENNELLY. The only answer I can give us is, don't you think that there is a degree of difference in the risk in extending a loan to the Dutch Government as compared with the preferred stock of a neighborhood grocery store?

Mr. WELCH. Well, I wouldn't think so. If you are going to revive small business, as we hope it will be revived, it cannot be accomplished by piling on an interest rate that will be back breaking.

You might better take the chance than to have them go into a business where they will be burdened with an interest rate out of proportion to their profits.

Mr. FENNELLY. Mr. Welch, I can answer that to the best of my judgment by saying that I think that the importance of interest rate or the dividend charge, if it is a preferred stock or a common stock, in the success or failure of a business is vastly less important than the availability of capital when they need it.

It seems to me that most businesses that I know, that if they need the capital and they want it for expansion, that the question of whether they pay 4 or 5 or 6 percent of interest or a dividend rate is not material—is not nearly as important as their ability to get the capital.

Mr. WELCH. You referred to the security behind the loan to the foreign country, to aliens. Our sad experience of the past hasn't proven they are very good risks.

Mr. FENNELLY. I wouldn't want to argue that with you.

Mr. WELCH. The chance in loaning the money to a corner grocery, to somebody in a legitimate industry, a small industry, is less than some other risks the country has taken.

Mr. FENNELLY. Granted. That is perfectly true, Mr. Welch, but I do want to emphasize the necessity of distinguishing between the different kinds of risks.

There are risks of all kinds and variety and I don't think this problem will be solved by attempting to assume that all risks are the same and that therefore they should be charged the same rate of interest.

Mr. WELCH. It is either a bad or a good risk at the beginning, is it not?

Mr. FENNELLY. Well, you hope it is. You certainly wouldn't undertake it unless you hoped it was good, but you would——

Mr. WELCH. Isn't there an element of chance?

Mr. FENNELLY. Yes; but the element of chance——

Mr. WELCH. An element of chance in overburdening the small businessman by an excessive rate of interest?

Mr. FENNELLY. I don't believe you are overburdening him if you make an honest evaluation of the risk involved and he has a business future or a reason for expansion that he thinks he can make money on, and if he can get the capital, it is my experience that the rate of interest, within reasonable limits, is a very minor factor in his success or failure; but I think it is a very important factor from the standpoint of the man, the banker, or investment company, that issues the credit.

Mr. WELCH. Might I ask just one more question?

The CHAIRMAN. Yes.

Mr. WELCH. Would you care to estimate the amount of capital that will be available for investment in both large and small businesses in this country after the war?

Mr. FENNELLY. No, sir; I don't know how I could do it. All I am convinced of is that there are tremendous funds available, if the proper catalytic agent is provided to unlock them, and I have tried to give some of the factors that I thought were necessary to bring that about; but the actual statistical estimate in that field is beyond me.

Mr. WELCH. You stated at the beginning that the capital available would be in excess of the opportunities for investment?

Mr. FENNELLY. No, sir. If you got that impression, that was exactly what I did not intend to imply.



Mr. WELCH. I am sorry.

Mr. FENNELLY. I said I knew there were a lot of people that were fearful that savings were piling up and would continue to pile up in excess of capital opportunities. I said that I was convinced from seeing many businessmen from all over the country and becoming acquainted with their plans for the postwar period, that there was no serious need for being concerned on that score, that the need was for channeling the capital to the places where it was going to be needed, and that the needs were going to be substantial.

I am not capable of giving you any statistical estimate as to the basis of that belief.

The CHAIRMAN. Mr. Voorhis. I am sure that you have some questions on this subject that you want to ask. It is right down your line.

Mr. VOORHIS. Mr. Fennelly, you spoke about a catalytic agent. If we look on this thing from a historical standpoint, what the history of small business has been in America over the past few years, we are going to need pretty much of a catalytic agent if we are going to solve the problem.

Mr. FENNELLY. I think so.

Mr. VOORHIS. It seems to me that your principal catalytic agent in here—I would like to say first that I am open-minded on this. I think maybe you have got something; on page 13 you speak about your principal catalytic agent: "We urge investment dealers throughout the United States to participate actively in this movement."

In other words, it seems to me that something is going to happen for the benefit of small business that hasn't happened so far. Why didn't it happen before?

Mr. FENNELLY. Well, I can give several answers to that. In the first part of your question; Yes, partly; but not just the investment bankers.

Mr. VOORHIS. I don't think it was investment bankers. It was local—

Mr. FENNELLY. Local citizens. I am convinced that there is a tremendous—that there will be a tremendous—rebirth of community spirit in this country and a tremendous interest in tackling their problems at home. If that is true, I do believe that these funds and managerial ability will be forthcoming.

I grant you are perfectly correct in saying that there is no guaranty that there will. Certainly I would like to see it tried before I assumed that it wasn't so.

Mr. VOORHIS. Isn't it true that given and granting an increased local interest in these problems, one reason for it is due to alarm over the disastrous manner in which small business has been pushed to one side in this country, not only during the war, although that has been bad enough? Now—to go back just a little—you said you believed that an insurance plan would be a major threat to the system of private enterprise in the United States.

Mr. FENNELLY. I don't say just an insurance plan. I am talking about the use of Government credit and Government guaranties in the peacetime period.

Mr. VOORHIS. I think that is what I am talking about. I am talking about an insurance plan for private lending. I am not talking about direct Government lending.

Mr. FENNELLY. If it is an insurance plan backed up by Government credit, it seems to me it does involve the use of direct supervision and passing of judgment on individual credit.

Mr. VOORHIS. My question is whether you think the Federal Housing Administration has been a threat to the country.

Mr. FENNELLY. No; I don't, and I specifically excepted that because I pointed out on page nine that there are exceptions to that generalization and the exceptions are where Government credits are based upon some simple standard form of asset and where the human equation is reduced to a minimum, and I specifically mentioned the Federal home mortgages and the Federal farm mortgages, but I am glad you raised that.

Mr. VOORHIS. Do you believe that expert technical advice and assistance can possibly be given to small business, short of absolute insistence on the part of somebody pretty darned powerful that that be given to them, at this time? My impression is that there are blocs against small business getting the advantage of any of that assistance that are perfectly colossal in their strength, and I don't know whether anybody except the Federal Government is big enough to make it available to small business.

Mr. FENNELLY. I don't agree with you.

Mr. VOORHIS. I didn't think you would.

On taxes, I wanted to ask you why you limited the exemption to the first \$2,000 of corporate net income. It would seem you could make it a little higher.

Mr. FENNELLY. It is for a number of reasons. One is in order not to undercut the base of Federal revenue. That figure runs up into substantial sums. Admittedly this is an arbitrary figure, but it was an endeavor to put it somewhat on a basis of comparability to an individual income-tax recipient with a normal family credit.

Now if the Government revenue needs could stand a larger exemption, there is no objection in theory or practice on my part.

Mr. VOORHIS. Mr. Folsom asked you whether you believed that so-called double taxes of dividends should be eliminated, and I want to ask you whether, if an attempt were made to do that by exempting from corporate income tax that portion of income that is paid out in dividends, you would then agree to revive in some form the undistributed profits tax?

Mr. FENNELLY. That is a very difficult question.

Mr. VOORHIS. It is involved in any approach of that sort?

Mr. FENNELLY. It certainly would be, but I am not prepared to take a definite stand on that one.

Mr. VOORHIS. All right. Now, I wanted to just conclude by taking a polite but extremely earnest exception to your paragraph under the title, "The Fog Surrounding the Problem."

It happens that I am the author of a bill to provide for a system of insurance through the smaller loan banks. I have no interest in a perpetuation of Federal bureaucracy or attempting to drive a permanent wedge between small or large business or to undermine private enterprise, as you say these things could do.

Mr. FENNELLY. No; I don't say that. I say that the small business problem has acquired a political tinge. I think that there is ample sincerity on the part of most people working on the problem.

Mr. VOORHIS. Isn't the reason the problem has acquired that tinge that anybody can see that unless there is some action on the part of somebody who cares about the future of small business and is in a position of some little power, the normal trend today is so strongly in the direction of monopoly that a small business is going to be a thing of the past?

Mr. FENNELLY. I don't know. The whole basis of this program is that there is a small business problem. I agree with that thoroughly; but as to whether or not I agree with as sweeping a statement as you make, I don't know enough about it to know.

Mr. VOORHIS. I am not for Government-direct loans. I agree entirely with your criticism on that. As soon as a Government agency comes along and decides that Joe Doakes is a good risk and Pete Smith is not, it is doing something that the Government has no business to do; but I don't agree with your criticism and your throwing out of account any proposal for Government insurance of loans privately made on the basis of private judgment of the man that makes the loan.

Mr. FENNELLY. Let me answer you this way. I don't know of any system of that kind that doesn't involve at least second-scale judgment on the part of the Government of the individual loan, that if they are going to guarantee a loan, they must pass judgment on that individual loan. I do not know how you avoid that. They certainly are not going to agree—at least I hope they are not going to agree—to taking on any loan, guaranteeing any loan regardless.

I think the diversity of small business is so great that there is no possible formula that you can set up, as you can for farm mortgages or home mortgages, and that in the inability of the Government to do that it comes back to the judgment regarding the entrepreneur of the business, his character and ability, and I don't believe that the Government is capable of judging the man in California or Kalamazoo on the basis of guaranteeing his credit any more than making direct loans.

Mr. VOORHIS. They might accept the judgment of the local bank.

Mr. FENNELLY. Then they are accepting it blind.

Mr. VOORHIS. I think that is all.

The CHAIRMAN. Mr. LeFevre.

Mr. LEFEVRE. I think the plan as you have outlined it here is very commendable and is probably just the thing that we need to fill this so-called gap.

Now, you said that the issuance of class A and class B stock was more or less followed after the Federal Land Bank system.

Mr. FENNELLY. Yes.

Mr. LEFEVRE. I don't recall how that worked out, but it seems to me that the farmer borrowing the money was obliged to take the class B stock.

Mr. FENNELLY. It wasn't called class B stock. It was a stock in an association.

Mr. VOORHIS. That is right.

Mr. FENNELLY. I am sure there are plenty of people around the room that can explain it.

Mr. LEFEVRE. That wasn't paid back to the farmer until he paid his loan off?



Mr. FENNELLY. That is right.

Mr. LEFEVRE. As I recall here, your class B stock is for sale to the general public.

Mr. FENNELLY. No; the class B stock is entirely stock that would be issued to the recipient of a loan, to the man who sold securities to the investment company, and there would be no compulsion on the part of the investment company to require that.

If they thought the credit was good enough without this premium, without making him subscribe, there would be no compulsion that would compel them to do it, but we say that is the only way to provide a cushion against the inevitable risk in this kind of business and at the same time assure the borrower that he has a run for his money that he puts up in that, because if the record of the company is a good one and they don't incur the losses that are very likely in this kind of business he can get back everything he puts up. That is the theory.

It is a kind of a cooperative scheme of insurance.

Mr. LEFEVRE. A man of my acquaintance showed me a copy of the New York Tribune where they showed three large companies taking over small companies, and he said that if this keeps up we won't need any small business. In my part of the country, people up there, the smaller plants, are very worried over the question of co-ops. They are coming into the picture in communities and taking all the business.

Have you any comment on that? What should be done to stop this sort of thing?

Mr. FENNELLY. No, sir; I am afraid I haven't. This problem of cooperatives I know involves separate problems of taxes. I have an instinctive sympathy for consumer cooperatives in all sorts of lines, but I can see that they do raise serious questions of cutting the tax base, but, except for the tax problem, I don't see any reason for great concern that they are going to run profit-making businesses out of existence.

Now, I am no authority on the subject, sir, and I just pass that as a casual observation, and I would like to say this about small businesses disappearing.

I think you are going to have the most terrific rebirth of small businesses when the servicemen come back to this country and men in the war plants get off with some savings that we have ever seen. There probably are going to be a lot of business births that will result in a very serious death rate a few years later.

I think that is the danger, but I feel that if small business is given a chance after the war—and I am one who is heartily in favor of giving it every possible chance in fighting monopolistic tendencies that Mr. Voorhis pointed out—I think we are going to have a tremendous revival.

Mr. LEFEVRE. On the other hand, I am afraid there is going to be an awful death rate.

Mr. FENNELLY. Isn't that what private enterprise is? It is the taking of risk and the willingness of individuals to take such a risk. We cannot protect a man.

Mr. LEFEVRE. We can't make the private enterprise pay taxes and the co-ops go without paying taxes.

Mr. FENNELLY. That is certainly a danger. I haven't studied the subject enough to have a specific judgment on it, although I see that you have a very serious problem.



The CHAIRMAN. Mr. Simpson, do you have a question?

Mr. SIMPSON. Yes. If a small retail business needs credit, is there any reason why they can't go to the bank and get that credit?

Mr. FENNELLY. No, sir; not that I know of. There are undoubtedly banks that are more willing than others to finance small businesses, but I am convinced of this: That the basic problem is one of permanent capital. It is very easy for the small businessmen to get bank credit if they have an adequate cushion of permanent capital. It is extremely difficult for a bank, no matter how willing it is, to extend credit on the basis of their demand deposits to a business that is inadequately financed with permanent capital.

I don't know whether that is a satisfactory answer to you, but we think that the major job to be done here is a provision of permanent capital and equity capital, and if that is done the bank-credit problem becomes easier to handle.

Mr. SIMPSON. My experience in Illinois has been that if a retail merchant needs credit and is entitled to it he can go to the local bank and get it and if 5 or 6 or 10 people want to start a corporation, they can put ten or fifteen thousand dollars in it; and if they want to start with \$100,000 in a corporation, they can raise part of that money and get the balance of credit from the bank.

Mr. FENNELLY. In other words, you don't believe there is likely to be after the war a real problem of small business getting the capital they need through the existing—let's say—institutional machinery but through local sources?

Mr. SIMPSON. If a returning soldier wants to start in business under certain credit conditions he can get the credit, if he wants to operate a filling station or any other small business, but with the banks bulging with funds it looks to me like they ought to be willing to lend it.

Mr. FENNELLY. Yes, for short-term credit purposes, Mr. Simpson; I think they are. But what we are talking about is not an individual returning soldier but the ability of an existing company that has a capital of \$50,000 to raise \$50,000 more of permanent capital for plant expansion, and I am convinced that there is a real problem as to where that man goes today to get that capital.

Mr. SIMPSON. Maybe his tax is a little too high.

Mr. FENNELLY. I have no doubt about that.

Mr. SIMPSON. That is all.

The CHAIRMAN. Mr. Fennelly, we are very grateful for your splendid statement, which reflects much thought on these problems.

I believe that Mr. Murdock, before you leave the stand, has a brief question he wanted to ask you.

Mr. MURDOCK. Do we have another witness?

The CHAIRMAN. Yes, we do.

Mr. MURDOCK. I will take only a moment.

Mr. Fennelly, you spoke once of this wholesome prosperity, which we hope for, needing some sort of catalytic action but I take it from the first part of your remarks that guaranteed employment would not be such a catalytic.

Mr. FENNELLY. No; I wouldn't regard it as such. Exactly the opposite.

Mr. MURDOCK. I think perhaps I might agree with you, but I merely call your attention to one thing, and that is this: That if it

is unwise for the Government to guarantee employment, it is by the same token incumbent upon business to see that employment is guaranteed.

Mr. FENNELLY. It is a question of—

Mr. MURDOCK. It increases the obligation.

Mr. FENNELLY. It increases the obligation. It comes to a question of what you mean by guarantee. I am convinced that we won't have a satisfactory economy unless we maintain a satisfactorily high level of employment, and I think there are quite a lot of things that the Government can do to help that, both positively and negatively.

It would not, in my opinion, include an outright guaranty.

Mr. MURDOCK. Do you think the feeling of businessmen generally is to recognize that obligation?

Mr. FENNELLY. I think more and more they are. I can't speak for business as a whole. I can only speak for one businessman, but certainly there is an awareness of the problem today that they didn't dream of a number of years ago.

Mr. WELCH. In cases where the Government is responsible for a large industry absorbing a small industry, should not the Government assist the small in rehabilitating itself?

I could give you many examples, cases where the Government did not benefit by permitting the absorption of small industry by large industry; it did not either expedite production or lessen the cost.

Mr. FENNELLY. Do you mean something—I am still a little baffled—something that has taken place during the war?

Mr. WELCH. Exactly.

Mr. FENNELLY. I said at the outside that I was excluding the problems of reconversion loans. Certainly I think that the Government, where it has converted an industry to war production, has some obligation to see that that industry is not wronged in getting out of the war production. If that is what you mean, I am all for these reconversion loans, and again what I am talking about is a period beyond that, a postwar system.

Mr. WELCH. I know many cases in my section of the country where small businesses have been absorbed or practically destroyed during the war. I have always felt that it was the responsibility of the Government to rehabilitate these industries.

Mr. FENNELLY. I just wouldn't have any judgment unless I knew the specific circumstances.

Mr. WELCH. I will not take the time of the committee, but I will be glad to give Mr. Folsom the specific cases.

Mr. FENNELLY. I apologize for taking so much of the committee time, Mr. Chairman.

The CHAIRMAN. You provoked so many thoughts by your statement.

Gentlemen of the committee, this is Pan-American Day, there is no legislation coming up. We have Mr. Draper of the Federal Reserve Board. We have been rather deliberate in our questioning of Mr. Fennelly. I am just wondering if it would be agreeable to the committee to go ahead with Mr. Draper at this time.

Would you prefer to come back after lunch? I think maybe we could hear Mr. Draper, certainly in 30 minutes, and if that is agreeable to the committee, we will proceed.

Mr. Draper, without further remarks on my part, will you proceed?

## STATEMENT OF ERNEST G. DRAPER, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. DRAPER. I have here a relatively brief summary of a longer statement which with your permission I would like to file with the committee in the next few days. If you have no objections, I would like to read this statement. It will take about 15 minutes.

The CHAIRMAN. Without objection, that order of procedure will be followed.

Mr. DRAPER. I have entitled this, "Supplying the Credit Needs of Business in the Transition and Early Postwar Period."

At the outset may I make a personal affirmation of faith. I believe in the private-enterprise system. My 29 years in business and my subsequent 10 years' work in Washington have confirmed me in the belief that for the United States the system of private enterprise is the one that best suits our national temperament and our great abilities.

This system has its faults, but so has every other system with which I am acquainted. For us now, and in the foreseeable future, therefore, I believe we should judge the great problems of reconversion and after, from the standpoint of how we can strengthen the private enterprise system so that it will contribute its full share toward vitalizing the economic and social health of this country and, in due course, that of other countries in the world as well.

When we talk of private enterprise, many of us think primarily of trade and industry. We are apt to forget agriculture and banking and, in particular, the small country bank which in its individual sphere of activity can be of great force for community good.

With this viewpoint in mind, I should like to discuss the problem of providing medium and long-term credit by the banks as an aid in developing and sustaining healthy private enterprise, particularly in the field of trade and industry.

### INTRODUCTION

If we are to have full employment after the war the transition from war- to peace-time operations of business must be accomplished promptly and smoothly. The problems of reconversion may well be greater, particularly for small and medium size business, than were those of conversion to war production. One of the most vital problems of the transition and early postwar period will be that of obtaining adequate financing.

In addition to short-term credit for supplying working capital, medium and longer-term credit will be needed (1) to convert machinery and other plant facilities from the production of military to civilian supplies, (2) to rehabilitate run-down and replace obsolete, plant and equipment, and (3) to acquire unusual amounts of inventory which would otherwise be taken over by the Government and disposed of as surplus war property.

The important question is not the amount of postwar credit needed by business, but the assurance that what is needed will be made available. It is essential to the program of full employment that no business, large or small, with reasonable prospects for success under peacetime conditions will lack credit.



Many of us who have been close to the situation believe that the private-enterprise system is best served when credit is supplied by banks and other financing institutions which are themselves part of that system of private enterprise. The question then arises as to whether, in any substantial number of cases, private financing institutions will be unable to furnish adequate credit to worthy enterprises because of the relatively high risk involved.

We have every reason to believe that there will be many such cases. There have been within the past 12 years, during the depression period and during the war. These situations have been met in two general ways: First, by the provision of facilities for direct lending to industry by Government; and, second, by utilization of the partial insurance principle, under which Government aid extends only to guaranteeing, in part, credit which is extended in the first instance by private financing institutions.

While direct Government lending or financing of industry is doubtless justified in periods of extreme economic emergency, when private credit institutions become ultraconservative, or under war conditions, when construction of special war facilities is necessary, there is as yet no evidence that such financing will be necessary during the reconversion period.

Instead of setting up Government lending agencies, it would be better, if we mean to preserve the free-enterprise system, to assist the existing private financing institutions to function effectively in meeting the various credit needs of business in the communities they serve. Otherwise, we undo with one hand what we are trying to do with the other, since Government direct lending agencies often tend to compete, to a greater or lesser degree, with private business in the field of banking.

#### *Extent of credit needed in the reconversion period*

While the early postwar credit picture is far from clear, it appears likely that the total need for short- and medium-term borrowings will not be great. We are confronted with a mixed situation. There are certain factors tending to lessen the need for credit. For example, business, including small business, has, by and large, improved its financial position during the war.

Many business enterprise undoubtedly have ample liquid resources to go through the reconversion period without borrowing. Other factors indicate an especially acute need for credit in individual cases or special situations. Instances of this sort are provided by nonwar small businesses, enterprises that have not done well during the war, and new businesses or new ventures by established concerns. This mixed and rather incalculable outlook calls for a flexible credit policy, one capable of dealing with off-standard situations and border-line risks.

Where credit is needed by business, it will be needed acutely. Not only the existence of particular enterprises but the employment capacity of the Nation will depend upon the prompt and adequate availability of funds for reconversion purposes. The question, therefore, is the extent to which credit, especially private bank credit, will flow into the area of acute need and relatively high risk. The problem is not one of relief but of maintaining the present prosperity and full employment under circumstances of readjustment.



As far as resources are concerned, it can be stated without hesitation that the credit resources of the banking system are sufficient to meet any and all credit requirements of the reconversion period. These resources are distributed throughout the Nation in some 14,000 banking institutions, each in touch with the business and industry of its own locality.

Three billion dollars in war production loans at present outstanding will be retired in large part during the process of contract settlement. A large part of this will have to be replaced with bank credit for civilian purposes. Whatever the credit demands may be, however, our private banks and the Federal Reserve System have ample resources to meet them.

There is no question as to the willingness or desire of the private banking system to provide adequate financing for reconversion. But in doing so it may need the protection of a partial guaranty similar to that now provided in the V and T loan programs, if it is to assume the border-line risks.

The V loan was established by Executive order and the T loan by the Contract Settlement Act of 1944, but these loans are strictly limited to the financing of war production and contract termination. Provisions for this type of loan insurance or guaranty is contained in the Wagner-Spence bill—S. 511 and H. R. 591—which is now in the hands of the Banking and Currency Committees of the Senate and House.

#### *The marginal area of risk*

Banks, like other private business enterprises, exist for purposes of profit, and they are also custodians of the funds of their depositors. Responsibilities to stockholders and depositors place natural limits upon the degree of loan risk that should be assumed. However, there is a marginal area of risk between financing which is fundamentally uneconomic and financing which the banker can reasonably be expected to supply. That is the area into which the partial guaranty principle enables the banker to venture by reducing his lending risk.

The change-over which will be faced by many businesses in the reconversion period, from a one-customer market—the Government—to the competitive markets of peacetime will bring to the banker many new and perplexing credit problems. There will be many businesses with balance sheets that do not show credit positions which would justify advancing to them any substantial amount of credit out of the funds of depositors.

Small- and medium-size business, which has difficulty in raising equity capital and which often, moreover, resists the idea of increasing its equity owners for fear of forfeiting its independence, will want especially the medium- or long-term loan for purposes of buying new equipment or surplus war inventory and other property. As already indicated, it is in the public interest that credit be made available to many of these marginal risks.

#### *Development of the loan guaranty principle*

Fortunately, an 11-year period of actual experience indicates how the reconversion credit problem can be successfully met by the private banking system with a minimum of Government participation.

Two acts were passed in 1934 which contributed to this experience—the National Housing Act and the act of June 19, 1934. The former

provided for Government insurance of bank loans to revive the home-construction industry. The latter, by adding section 5d to the Reconstruction Finance Corporation Act and section 13b to the Federal Reserve Act, provided for both direct lending and the guaranty of bank loans to business and industry. The previous year Congress had also provided for the insurance of bank deposits.

The result of these enactments was to revive the flow of credit, which had been slowed up by the depression. Private enterprise, both in industry and in finance, was assisted through governmental action. But, by putting the Government into the direct lending field, Congress at the same time made possible Government competition with private enterprise.

Insured loans worked out successfully in Federal Housing Administration financing. Likewise, experience of the Federal Reserve banks under section 13b has shown that the best position for a central bank lending agency to take in fostering business credit is not the direct loan to industry but the partial guaranty behind a bank loan. This is logical, inasmuch as the small- and medium-sized business is essentially a community enterprise and is best financed by the local banker, who is in close touch with his customers.

The V-loan program, one of the outstanding credit achievements in the history of American banking, is a guaranty or insurance plan. Executive Order No. 9112, issued by the former President under his wartime powers on March 26, 1942, gave the War Department, Navy Department, and Maritime Commission power to guarantee loans made by banks and other financing institutions for purposes of financing contractors, subcontractors, or others engaged in any business or operation deemed to be necessary, appropriate, or convenient for the prosecution of the war.

The Federal Reserve banks were authorized to act as agents in carrying out the provisions of the order, subject to the specific instructions of the guaranteeing agencies and the general supervision of the Board of Governors of the Federal Reserve System. On April 6, 1942, the Board of Governors issued its regulation V, prescribing general rules and policies for the guidance of the Reserve banks and, incidentally, giving the V-loan program its popular name.

The V-loan plan was devised to assure adequate credit for war production, which many of the small subcontractors were finding it difficult or impossible to obtain. While businesses of every size were benefited, the V-loan program became especially the mainstay of the small subcontractors. Sixty-two percent—in number—of all V-loans have been made to enterprises with less than \$500,000 total assets or with less than approximately 150 employees. How readily the banks availed themselves of the opportunity to make these reasonably safe loans is evidenced by the fact that to date 9.5 billion dollars of bank credit has been made available to war contractors under authorized regulation V loans.

At midyear of 1942, when the plan was only a few weeks old, 2.3 billion dollars of bank loans for war purposes were outstanding, of which only 4 percent were V loans. By the middle of 1943 total war loans of banks had increased to 3.3 billion dollars, of which amount 44 percent was guaranteed, in part, under regulation V. The end of 1943 saw bank war credits at their peak, with 3.5 billion dollars out-

standing. At this date 55 percent of all war loans were guaranteed under regulation V. By June of 1944 bank loans for war purposes had dropped to 3.2 billion dollars, but V loans had continued to increase, amounting to 2.1 billion dollars, or 66 per cent of the total.

Business was now in a generally stronger financial position, and the banks were beginning to make more loans without the guaranty. Thus, at the end of 1944 bank war loans of 3.2 billion dollars were outstanding, the same amount as on June 30, but the V loans had declined to 1.7 billion dollars, or 54 percent of the total.

The guaranteed loan program will automatically disappear with the settlement of canceled war contracts, just at the moment when reconversion is beginning, unless the plan is extended through the passage of the Wagner-Spence bill—S. 511, H. R. 591. This proposed legislation provides in general for continuing the V-loan method under Federal Reserve System supervision and applying it to the credit problems of reconversion.

The bill amends section 13b of the Federal Reserve Act. First, the restriction on the making of loans to provide working capital only is removed. This is because loans for the acquisition of plant and equipment will be in much demand.

Second, the restriction of loans to a maximum 5-year maturity is removed. This is because in many cases medium-term loans of longer than 5 years will be necessary.

Third, the 80 percent guaranteeing limit is raised to 90 percent. This change is based on the V-loan experience, namely, that banks will need that much protection in many of their loans, particularly the smaller ones.

Fourth, the \$139,000,000 that was appropriated in 1934 under section 13b is made available as a guaranty fund. Finally, the direct lending provision is eliminated. These new powers are provided only for a period ending December 31, 1949, so as to make it clear that the program must be reexamined at that time.

The total guaranteeing operation under this bill cannot be as large as the V-loan operation but can be about as large as the V-loan program in the two bottom-size brackets; that is, to borrowers with assets under \$500,000. On the 4-to-1 ratio provided in the bill, the total guaranty or commitment outstanding could be about \$500,000,000. Assuming an 85-percent average coverage of the total risk, which has been the experience under the V-loan program, this would provide over \$600,000,000 of bank credit outstanding at any given date.

It is believed that this legislation should be adopted without further delay, for the reconversion period is imminent. The loans made would be made by private banks. To the extent that they are made without reliance upon the guaranty, so much the better.

As with the V- and T-loans, the fee which the lending banks would pay for the guaranty would increase with the percentage of the loan guaranteed. Hence, an inducement would exist for the banks to assume as much of the risk as they felt they safely could. No appropriation would be required from Congress, since the fund originally provided under section 13b, which would be made available, should constitute an adequate guaranty fund.

Of all the plans by which Government would provide business and industrial credits in the period of transition, the Wagner-Spence bill most fully conforms to the policy of doing the job and at the same



time preserving private enterprise. The relationship between the business enterprise and its local bank should not be interrupted or disrupted. The success of the V-loan program in liberating \$9,500,000,000 in bank credit on the high-risk margin of war production is our best guide to the principle that should be used in fortifying the bank credit situation of business and industry under the great strains that will undoubtedly be encountered in the transition from war to peace.

These thoughts must have been in the mind of Justice Byrnes when, as Chairman of the War Mobilization Board and on two separate occasions, he strongly recommended the passage of the Wagner-Spence proposals.

This is a personal statement and I have not undertaken to clear it with the other members of the Board of Governors of the Federal Reserve System.

(For supplemental statement submitted by Governor Draper, see exhibit 1, p. 2489.)

The CHAIRMAN. Thank you very much, Mr. Draper. I assure you that we all deeply regret the fact that the unexpected call of the House will interfere with the orderly procedure of propounding questions by the members.

We are grateful to you for this splendid statement and I am sure that it will be of much value to the committee.

Mr. VOORHIS. Perhaps later on we might invite Mr. Draper back.

The CHAIRMAN. We will be happy to do that, Mr. Voorhis, if we can.

Mr. FOLSOM. We have only one witness tomorrow—Mr. Krug—but I am afraid that you will have so many questions of him that you won't be through before 12 o'clock.

Mr. DRAPER. I am perfectly willing, Mr. Chairman, to be let off easily.

The CHAIRMAN. I am sure you would be able to take care of yourself.

The committee will stand adjourned until 10 o'clock tomorrow at this point.

(Whereupon, at 12:15 p. m., an adjournment was taken until 10 a. m., Wednesday, April 25, 1945.)



# POSTWAR ECONOMIC POLICY AND PLANNING

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THURSDAY, APRIL 26, 1945

HOUSE OF REPRESENTATIVES,  
THE SPECIAL COMMITTEE ON POSTWAR  
ECONOMIC POLICY AND PLANNING,  
*Washington, D. C.*

The special committee met, pursuant to adjournment, at 10 a. m. in room 1012, New House Office Building, Hon. William M. Colmer (chairman) presiding.

Present: Representatives Colmer (chairman), Murdock, Fogarty, Gifford, Reece, LeFevre, Welch, and Simpson.

Also present: M. B. Folsom, staff director; H. B. Arthur, A. D. H. Kaplan, and C. A. Sienkiewicz, consultants.

The CHAIRMAN. The committee will come to order.

We have with us this morning Mr. John Clifford Folger, president, Investment Bankers Association of America, Inc., and we will be glad to hear from Mr. Folger at this time.

## STATEMENT OF JOHN CLIFFORD FOLGER, PRESIDENT, INVESTMENT BANKERS ASSOCIATION OF AMERICA, INC.

Mr. FOLGER. With your permission, I will refer to this memorandum, which will take about 12 minutes to read, then digress to emphasize certain points.

The CHAIRMAN. Just as you like.

Mr. FOLGER. I am a partner in the banking firm of Folger, Nolan & Co., situated here in Washington, D. C., and have been in the security business since the fall of 1929.

This country was built up around the practice of putting profits back into the business. Such a practice—putting savings into enterprise—is called investment. It is the most explosive and power-giving force in our economic society. Savings are like the gasoline in the tank of the automobile. Investment is like the pipe line which pipes the gasoline into the motor and makes it turn over. Cut the pipe line between the tank and the motor and the car stops. Cut the investment pipe line between savings and investment and the economic system stalls. That is what happened in 1929. And in spite of all the talk and motion, this pipe line, save for the war, has been more or less jammed ever since.

Our present rate of employment is made possible by 85,000,000 bond buyers who have loaned their money to the Government to produce war materials. The answer to peace jobs is in the hands of these same 85,000,000 bond buyers. If they will invest their savings in the peace-

time future of their country, as they have in her war purposes, there is almost no limit to what we can do.

When a citizen buys a war bond he is inclined to think he is buying a shell, a grenade, or a rocket bomb, or something that can be exploded. He may not think of his investment as part of the job-making process, whereas it is this money spent by the Government which now makes the wheels go round, rather than private money used in private business, as was the case in earlier days. When the guns cease and the war bond sales end then the question is, What is going to flow in this capital pipe line, this channel that keeps the motor going?

In 1929 bank deposits were around 55 billions. Now they are over 140 billions. In 1929 banks had 80 percent of their funds working in private business. Now it is the other way around—80 percent of their funds are in cash or loaned to the Government.

The story of life-insurance companies is well known. Of total assets in life companies, about 98 percent are of senior loans or mortgages. Between 1920 and the present time, holdings in Government bonds have increased from 19 percent to nearly 50 percent of their assets.

Mutual-savings banks in 1931 had 85 percent of their investments in private-enterprise securities and now 40 percent.

Everyone has gotten under the bed with their money and if they don't watch out they'll suffocate.

An interesting sidelight is that it has taken about 16 years for the capital funds of our deposit-banking system to catch up with what they were in 1929, a figure just short of 10 billions. Of course, we now have only half as many banks; or about 15,000 as against 30,000 in 1929.

In addition to the above funds, we have 26 billions outside of banks just floating around in people's pockets, in tills, or under mattresses.

There has been built up in this country a riskless theory of investment based on safety and liquidity. Everyone has built a Maginot Line which he figures will protect himself, irrespective of what happens generally. This pursuit of security by individuals and managers of capital may endanger the security of all.

There are 1,000,000 \$1,000 bills outside of banks in this country. There are 40,000,000 \$100 bills in circulation. This total amount of money outside of banks is about equal to the debt of the whole Nation at the end of World War I. It is several times the amount of money that was in circulation in 1933 when we had to have cash because the banks were closing.

The big real investor now is the Government, and for war purposes. When the war ends, who is going to take up the slack? This very properly directs attention to the private investment banking machinery. This is the channel through which private capital must flow into business. Some say the investment banker emerged from the doghouse only to jump into a fox hole. But hasn't everyone else connected with financial matters done just that, whether banker, investor, insurance executive, or John Q. Citizen?

I take it this committee wants to discover any barrier to postwar recovery. One of the first things to study is what has been stalling private investment.

By and large, I should say there is sufficient capital in the investment business to do the job at hand. Some estimates have placed it at over 300 millions with borrowing power of 2 to 3 billions. This capital turns over very fast, of course. It is that velocity which increases the risk for the investment business. As a matter of fact, the investment banker is now about the only venturesome spirit left in the financial world and he is getting somewhat timid with advancing years, and with his solitary role.

Last year, and so far this year, there has been considerable activity in securities markets. Most of the financing has been in refundings, but there is evidence of great demand for securities, especially of the safe variety. In this connection, it is interesting to observe that about 95 percent of securities registered and known to have been sold in the last 10 years were of senior nature: about 85 percent in bonds; and 10 percent in sheltered preferreds. Venture capital has slowed to a trickle. Postwar needs in financing are, of course, a matter of conjecture. Some estimates place annual needs to be covered by new public offerings at from  $2\frac{1}{2}$  to  $4\frac{1}{2}$  billions. We read the statement of Mr. Gifford indicating capital needs of American Telephone & Telegraph at around a billion. It is generally accepted there will be a great deal of new financing and some refunding after the war. We submit that investment bankers either have or can get the money to do their job, provided the climate is favorable for business development.

The main thing, of course, is to get business—the job-making machine—moving after the war. It is important that we rip out every practice or device that is standing in the way of savers putting their savings into private, productive investments. Certain bottlenecks are not far to seek.

At anything like present tax levels, no conscientious banker can put his clients in anything but more or less riskless investments. Some things can be done taxwise to help business. Favorable treatment of capital gains and losses of individuals and corporations and suitable periods of carry-forward and carry-back of operating business losses should be devised to encourage investment and employment.

The capital gains tax should be lowered, not increased, and should have continuity at a low flat rate. Rich people are facing the probability that the days of very large incomes are over. They will, however, take chances in the hope of increasing capital. Give the large investor his chance at capital gains, avoid soaking corporations before the money ever gets to the stockholder, help new and little business taxwise, and we'll do more than anything to get venture capital out in the open.

I want to stress here a point that I think is important in considering the machinery for distributing securities, and that is the very large volume of securities now bypassing the SEC completely through private placement. Large and sophisticated buyers are able to buy unregistered securities. This rapidly mounting practice, intended for special and unusual cases, has become a habit and is one of the best indications that registration rules need simplification. Maybe big corporations with their staffs can take 100-page prospectuses in their stride, but the little fellows are inclined to say, "Oh, what's the use." The Congress should take a look at the securities acts now that some 12 years of experience are behind us.



I have here a prospectus 8½ inches by 13 and nearly an inch thick that is supposed to go, and does go, into the hands of every buyer of a thousand-dollar bond of this issue.

Gentlemen, this complicated requirement is slowing down the distribution and merchandising of securities in our country. This large, thick prospectus has over 100 pages. Frankly, I haven't read that and I doubt if any investor has ever read it. I have heard insurance company presidents say they never read such tomes. Most people get their information from certain boiled-down and condensed statements, which are useful and serviceable in appraising security values. I feel strongly that here is one of the bottlenecks holding up the flow of capital.

If we are to persuade investors to risk their money in a dynamic economy, the Government must make things look encouraging. In my opinion, the SEC should be more concerned with the main purpose of getting savings into business rather than with the functions of regulation. A credit man in a store can refuse to sell goods except to a handful of those with proven credit. His record would be perfect and yet he would lose his job because there would be no volume of merchandise moved.

What we need is an awareness of the importance of getting private capital to work. This whole philosophy of reckless economy must be arrested. There has been a feeling that if the truth were told and filed with the SEC, there would be no losses. Conversely, it would therefore appear that any losses were due to misrepresentation. That is not the case. There is bound to be some turbulence, ups and downs, and losses in the postwar period. A continuing program of frightening capital and those engaged in providing it will not solve the problem. Capital will just remain under the bed. The man of tomorrow is the one who helps put that timid money to work. Top-flight men concentrating on that problem, with experience, understanding, and sympathy for investment problems, should be added to the Treasury and to the Departments of State and Commerce. That goes also for the Federal Reserve, and it wouldn't hurt the SEC. Timid capital needs encouragement and guidance from the Government, rather than competition.

A word about calculated risk. That's a military term. Commanders took calculated risks in Normandy. They are taking them every day. It may well be that large pools of capital, such as are controlled in deposit banks, mutual savings banks, insurance companies and trust funds, must set aside a certain percentage for what now might be called unconventional investments. All cannot play safe, as they now think they are doing, and still have private enterprise as we have known it. They must get down out of the grandstand and mix it up a bit with the players on the field. Otherwise there will be no game to watch. We may need some changes in laws and rules governing trusts and financial institutions, giving them greater flexibility as to fields of investment. If responsible people don't put money to work, the irresponsible men or some socialistic government will.

May I again refer to the fact that, in my opinion, no one segment of the population is at fault. We are all going down the same road. There is a tendency on the part of management of large capital to sit by the side lines rather than become aggressive in the solution of the problem.



In certain jurisdictions, trusts are not allowed to be invested in anything but the most highly secured bonds.

Mr. Mellon called the turn in 1929 when asked about the change in the market. He said, the market will end "when gentlemen prefer bonds." No one dreamed at that time the extent to which such preference would grow.

Investors are thinking primarily of two things. They are thinking of liquidity and safety. This attitude springs, in a way, from a fear complex. It might be compared to the attitude of certain New England sea captains. We are told about the old whalers who went so far away and their food gave out. When the seafarers returned home after a long absence, every time they went downtown they would buy some crackers and cheese to take home and hide in the rafters. They had a fear complex about running out of food. I suppose after an experience of that kind they never went back after whales again. But somebody had to go out and get the whales. I presume the answer was not to go so far, to take more food and to have better ships. Since 1929, people have placed inordinate stress upon safety and liquidity.

Unless there is a change, we are not going to have the vigorous dynamic business hoped for.

I am not offering the attached table as an exhibit, but I do draw attention to certain trends in finance.

Starting from scratch in 1933, we see corporate financing reach a peak in 1936 with \$4,800,000,000, then recede to \$1,000,000,000 in 1942. This is in comparison with, say, ten to twelve billions in 1929. In 1944 the figure was \$3,000,000,000. The first quarter of 1945 indicates about the same volume for this year, although the remainder of the year is anyone's guess.

Two revealing trends stand out in this table. First, the small amount of new private capital going into corporate financing averaging about \$600,000,000 per year, about one-sixth of the rate in the twenties.

Second, and I would emphasize this, is the large amount of securities which go the route of private placement and are not registered. These securities are taken out of the stream of offerings available to the rank and file of small investors. This fact stand out for good or ill. I doubt very much whether the framers of securities legislation realized how large this channel would become. Furthermore, it carries some very prime securities. Most the prime mortgage bonds on Washington utilities have been privately placed. Since 1936 nearly every prime utility bond in this community has been sold privately to the big buyers. Local buyers, the small one- and two-bond buyers, the small insurance companies, the church funds, do not get a chance to buy these privately placed securities.

There is considerable difference of opinion with respect to condition of plants and amounts of operating capital now held by corporations for use in the transition period.

Some people say corporations are rolling in cash and are not going to need much money. We mustn't forget we are going to need a lot more money than we have ever had in the past, because volume will be larger and prices higher than in prewar days. Furthermore, it takes more capital to finance ordinary business than to underwrite Government orders.

My own feeling is that corporations will need considerably increased amounts of operating capital. While the actual amount of cash held by corporations has increased, ratios between current assets and liabilities have in many cases decreased. In the thirties, volume and prices were declining and much less operating capital was required. For the transition and postwar period, conditions will be reversed. Volume will be increased over prewar, prices will be higher, and it will take more money generally to do business.

The CHAIRMAN. Will you pardon me for just a moment? I would like for this to go off the record.

(Discussion held off the record.)

Mr. FOLGER. My testimony is almost complete.

May I point out what are regarded as some of the present defects in our existing system of distributing securities. My thought is that security distribution should give prime consideration to the 1- to 5-bond buyers and the 10- to 100-share stock purchasers down in Mississippi, and in Tennessee, New York, and in my home in Washington. We must reach the 85,000,000 individual investors who now put their money into businesses through purchase of war bonds. If we are going to reach such investors and encourage them to put their money into enterprise, we must have a wide distributing system which is fair, and gives everyone the same chance at securities that may be offered.

With private placement of unregistered securities, the large, sophisticated buyer travels a different road than the small investor. He buys securities in large amounts and these do not have to be registered. This has a tendency to place first-rate securities in the hands of the large buyer, whereas the little fellow out in the country takes what is left.

This has been true of bonds and I can see where in certain conditions it would be true of stocks. I am told that private placement was intended by Congress to provide the exception for someone who was in trouble and needed a little money quickly, overnight, so to speak. This exception is rapidly becoming the rule. I am not drawing attention to this because misery likes company, but I do point out that it is unfair to the small security buyer and that it is not good merchandising.

Obviously, it is much simpler to drop by an insurance company office, talk with some officials, agree upon terms and make a deal without the delay and trouble of going through the SEC. I have had some private deals myself, but I don't think they are in the interest of the average investor.

Now, may I pay my very brief respects to competitive bidding. Under this system, the large investor gets what he wants. He can act quickly and can take advantage of opportunities. Competitive bidding injures the country-wide merchandising system for securities. Why wait for the little fellow to make up his mind whether he wants to buy a thousand-dollar bond and take the carrying risk when you can go to the big buyer and sell in a moment a large volume of securities? Private placement and competitive bidding have combined to remove the incentive to do a merchandizing job of securities evenly throughout the country.

The subject of price maintenance has, I believe, already come before this committee in some detail. In order to distribute securities fairly and evenly, a one-price system has been built up over a half

century. This provides market stability and gives the small and remote investor the same chance that a large, nearby investor may have. When you consider the 3 hours' difference in the time between here and California, you will see that the good things might all be gone before markets open up on the coast. Price maintenance in syndicate agreements is important with bonds and of very great importance, practically indispensable, to the orderly distribution of equities. One doesn't take so much risk with high-grade bonds, but on equities there is greater market fluctuation and more of a merchandising job is involved.

It may be poor taste for me to say anything about the SEC, or changes in the Securities Act. I might be compared to a baseball player complaining about the umpire. There is no thought of eliminating the SEC. That agency is performing a very useful and necessary function, but I do believe that some changes in the rules are needed. It was necessary to move the goal posts 5 yards to keep the players from butting their heads into them when crossing the goal line.

I have already referred to the size of the prospectus. I really feel some people should be locked in a room and not released until the job of simplifying the prospectus is completed.

Here is a report an inch thick which represents months of effort on the part of the SEC and the industry to agree upon needed changes. It seems to me that Congress having originally passed the legislation, must and should arbitrate this matter so that some of the bottlenecks can be removed. I don't think we will get anywhere with respect to simplification of these procedures unless Congress really takes the initiative and completes the job.

The complexity of the registration process, the awkwardness, the forms, the many exhibits, the complicated rules, are frightening and have a tendency to slow things down.

Then there is the inclination on the part of the SEC to use its broad powers in a supervisory way to interfere unnecessarily with business.

Lifting the exemption on registration from \$100,000 to say \$500,000 or \$1,000,00 would help little business.

In closing may I say that there is reason for striking an encouraging note. It has been my experience and observation that businessmen generally are inclined to go all out for expansion and employment.

The figures I have shown you on corporate financing since 1933, may take a very sharp upturn after the war. They must take a decided upturn.

So far as new money is concerned, we may need as much in one postwar year as has been put out in five or more years during the thirties. This is the postwar requirement that must be considered. Whether individuals will feel like putting up that amount of private money may be a matter of psychiatry. Mental attitudes will have a great deal to do with finance. Possibly the most important problem is to get the mental attitude of investors in an optimistic state.

Mr. Chairman, I believe that concludes my testimony.

Mr. GIFFORD (chairman pro tempore). Mr. Folsom, do you have any questions?

Mr. FOLSOM. He has covered all the questions I had in mind. I gave him a list beforehand of some of the things I wanted him to discuss, and I think he has adequately covered them.



Mr. GIFFORD. I simply want to observe that I have a scrapbook in my office containing material regarding the doings of the Securities and Exchange Commission, which we watched very carefully for a time, but like all other things we set up here, after a while we forget all about them and they carry on as they please.

I argued today that I think the Securities and Exchange Commission might well act upon complaints, but not, as you say, supervise the functions of everybody and make them await their decision when the time for investment may have gone by. They have certainly been a very great disturbance.

As an investment banked, you want to be the distributor?

Mr. FOLGER. Yes, sir.

Mr. GIFFORD. I remember those good old days. I was invited to take part in many proceedings where we might get control of all the barber shops, and if we could control the barber shops then we could determine what should be paid for a shave. If we could show an investment banker we could do that we could get the money.

Now, the Government not only furnishes capital, but guarantees against loss. That has gone to a very great length and is still going at a very fast pace.

Of course, I am worried about people wanting only security. They have been taught that, rather than take any risk in security investment bonds.

My people want to start up in business again after the war is over. They must expand. They tell me that they have not much money on hand. We have begged the Ways and Means Committee to let them set aside 15 percent for war recovery. Congress hasn't seen fit to do that.

I gather, from what you say, you want Congress to act as an arbitrator. Your prospectus there, was that made up to conform with SEC demands?

Mr. FOLGER. That is right, Mr. Gifford. Before one can negotiate a sale of a thousand-dollar bond of the described issue, he must place this large volume in the hands of the purchaser and get a written receipt for it. Of course we can't make the purchaser read the prospectus. There is no law to compel him to examine it. I submit when you make material of that kind so voluminous it defeats its very purpose. People just throw up their hands. I don't read them. Few if any people do. We take services that condense the material to one or two pages and thereby get the main facts.

The present prospectus is illustrative of the cumbersome nature of the forms which slow down the flow of capital.

Mr. GIFFORD. Of course it does. Congress, you say, should act as an arbitrator on simplification?

Mr. FOLGER. We had committees from various organizations in the business to meet with representatives of the SEC. Mind you, the SEC Commissioners are personal friends of mine, men of fine character. But, men don't give up power. They want to increase their authority rather than to diminish it.

If we are going to multiply by six times the amount of new capital in corporate finance which some say will be necessary, we must improve our merchandising technique and open up investment channels. We have seen 40 percent of the volume in securities sales skirting



around the SEC in private sales. That is evidence that a bottleneck exists.

MR. GIFFORD. For years I took the New York Times on Sunday and read the articles on finance.

How do you account for Congress refusing to call the businessmen in here? Do the businessmen fear the repercussions?

MR. REECE. I belong to the Committee on Interstate Commerce which formulated the original acts dealing with this subject, and we have had extensive hearings from time to time. It hasn't gone unnoticed, but we have been unable to do very much about it, and I presume the difficulty arises out of the indication that was given a while ago, the difficulty Congress has experienced in getting back power which it once gave away. These agencies don't easily come in and recommend that legislation be passed withdrawing some power that once has been given to them.

All of these subjects to which Mr. Folger has referred have been given some consideration by the Legislative Committee, which has jurisdiction. Somehow we have been unable to act under all circumstances.

MR. GIFFORD. Did you find that witnesses were fearful to testify?

MR. REECE. There has been no timidity on the part of people to testify and point out the changes that ought to be made. The timidity has rested with the committee dealing with the subject.

MR. GIFFORD. I have been a member of the Banking and Currency Committee and I have found that the businessmen have been fearful of testifying. People have a great fear of the Government over their business. They are fearful because they could receive dire punishment on rediscounting and all of that sort of thing. They are afraid of the Government in all directions, I find, and we can't get them here to testify.

You have noticed that, haven't you?

MR. REECE. They have been knocking at the door of the committee for many years, for an opportunity to testify.

MR. GIFFORD. I guess this should be off the record.

(Discussion held off the record.)

MR. REECE. Mr. Chairman, before this witness relinquishes his position before the committee, I want to say that I think he has made a very able presentation and one which should have the attention and consideration not only of this committee but of Congress and of the country, and I think his appearance here this morning has reflected a great deal of credit upon the Investment Bankers Association, which he heads.

There is a tendency for the people who are not in position to observe the personalities in a business organization to become prejudiced, unconsciously, and feel that they may be motivated by some motives other than the highest and most patriotic motives. That is, we have a tendency to attribute a selfishness to any position which they take, and the mere fact that the Investment Bankers Association elected a man of the type of the witness here before the committee, the action itself reflects a good deal of credit and should inspire confidence.

Having known this witness for many years, I can say that I know he is motivated by the same high principles of patriotism and interest in the welfare of his country that any of us are motivated by, and

he came from the same surroundings, the same atmosphere, and has the same interest in the welfare of our country that any of the rest of us have.

I am saying this more for the purpose of illustrating the approach which the organization which he represents has made to this whole problem, and it should inspire a very considerable degree of confidence on the part of those of us in the legislative branch who are undertaking to deal with this subject.

I am very greatly impressed with his approach to this subject.

As Mr. Folsom knows, I have discussed with him the importance of this committee making the study of this phase of the reconversion program. As Mr. Folger has indicated, it may be necessary for us to build some dikes and plug some leaks, but the most important thing we can do is clear the channels, and in order to do that we have got to open up an opportunity for reasonably free flow of securities. And I was glad to see him emphasize that there must be a certain degree of calculated risk taken. I think possibly the Securities and Exchange Commission may have erred more in that respect than in some of the others in trying to make sure that nobody assumes any material risk in the purchase of securities.

I probably shouldn't have said this much. I do want to refer further, however, to what the witness said with reference to certain amendments to the Securities Exchange Act, some of which are pending now before the legislative committee. There has arisen a question with respect to maintenance of price, which is also a bill pending before the committee. I presume you are familiar with that.

Would you care to express an opinion on it?

MR. FOLGER. If this price-maintenance feature in our syndicate agreements cannot be maintained, there will be further disturbance in the system of distributing securities, and that applies especially to equity capital, which is so important at this time.

Under the registration provisions it is understood there shall be one price stipulated for a security issue. Now, one can't have a price for a second and then a changed price. We must have consistency and orderliness in our market arrangements; otherwise, there is a disposition to run to cover, and sell if securities are a bit slow. Securities may be sound and worth more than the issue price, but if a feeling of panic prevails over the country, then, that security may sell many points below its real worth with a great injury to the merchants who have the securities on hand and to the public generally. People don't like to buy securities on a falling market.

There are a great many important factors involved and I certainly hope that the emendment to which Mr. Reece refers will be enacted into law. Otherwise, there will be a great disturbance in the security market.

MR. GIFFORD. Off the record.

(Discussion held off the record.)

MR. GIFFORD. Thank you very much, Mr. Folger.

MR. FOLGER. Thank you.

MR. GIFFORD. We have another witness to testify. We have Mr. J. Wilson Steinmetz, of Philadelphia.

Have you a statement?

Mr. STEINMETZ. I have a statement, but I do not have enough copies for the committee. I have made arrangements to have copies made and I will see that you get a copy.

The statement I have is a very short one. I come as an individual and express my own personal opinions.

**STATEMENT OF J. WILSON STEINMETZ, BANKER,  
PHILADELPHIA, PA.**

Mr. STEINMETZ. In spite of the improved liquidity of business shown by the cooperative study, Survey of Business and Finance 1939-1943, undertaken by the Federal Reserve System and the Robert Morris Associates, and the continued trend in that direction shown in statements already received by our bank this year, I believe we will have an increased demand for bank loans in the postwar period.

While we may receive less requests for the conventional type, short term, unsecured credit, I believe that because of internal changes in business, both in type of equipment and product and in the changed policy by management, there will be a built-up demand for loans to finance increased volume, increased plant facilities, and the replacement of inadequate or obsolete equipment. The latter types of loans usually result in increased demand for working capital to operate the new equipment, and if we are to maintain our economy on a basis sufficient to produce a national product as high as is indicated by some and to provide as many jobs as others believe are necessary, it will require financing.

We have received sufficient evidence from enough customers that they are contemplating the balancing of their production by the addition of machinery and from others who are contemplating replacement of obsolete equipment to lead us to believe we may expect to lend a fair amount of money.

It is fortunate that during the depression and the war periods banks generally learned new techniques in credit granting and that the method of financing the war effort has resulted in a liquidity among the banks which enables them to enter the period with a willingness and determination to do the job, whatever form it may take, provided it is consistent with sound banking procedure.

Loans for the expansion of business can either contemplate financing of current assets, such as accounts receivable and inventory, or a combination of current assets with fixed assets. The former type, if need be, can be secured by the pledging of accounts receivable and/or inventory, self-liquidating loans, providing for the fluctuation of these assets. Most State laws now provide for the pledging of these assets in one form or another.

Loans to finance the purchase of machinery, both out of the surplus owned by the Government and from private sources, as well as new types of machinery from producers, will undoubtedly be required. Where it is clear that the earning capacity will be sufficient to make these loans self-liquidating within a reasonable period of time, there should be no difficulty in obtaining the proper type of term loan to finance them.

Growth and expansion loans where there is sound management have never really presented a difficult problem.



There undoubtedly will be requests from marginal producers, who during the war period have improved their financial pictures somewhat and who will want an opportunity to demonstrate their ability to produce in competition in the postwar period. The degree of success of these businesses will depend largely upon the general economy. While the going is good, they may be fair risks but will have to be more carefully considered and watched in relation to the business cycle. Because of the present liquidity of banks, I think a larger number of these loans will be made than would have been made during the depression period when there was a general mad craze for liquidity.

There is a type of loan that we have always had requests for and always will, in which there is no special technique but the granting of which is largely a matter of judgment. I have in mind the out-and-out capital loan whether made to a company already in business for the starting of a new department or a special type of work in which they have had no previous experience, or to an individual starting in business where there is no previous experience from which to draw. These are largely character and capacity loans. Here the picture is quite obscure, and it may be in this area some applications for loans will arise where banks should not risk their depositors' money.

In addition to the above business loans, there will be a considerably larger volume of consumer credit financing by banking institutions to enable individuals to buy semidurable goods. We expect to do our share of this type of financing as well as personal loans to take care of personal expenses, which are altogether character loans.

We are already making known to our prospective borrowers, who are also our customers, by direct correspondence and personal visitation our willingness to consider with them their financial needs whatever they might be. To the community in general we are making it known through a publicity campaign, acquainting them through various means of advertising of the facilities which are available and of our desire to consider with them their individual problem, with particular appeal being made for the smaller business loans.

I believe from my contact with bankers generally that they are more awake to the need for providing financial assistance to every competent borrower than at any time in my 35 years of experience. I believe bankers generally recognize the need of providing credit facilities for their customers and that an enlightened self-interest demands that they exhaust every means at their disposal to see that their customers needs are satisfied.

It is my personal feeling that this is essentially the bankers' job, that they should be given every opportunity to make these loans themselves. If for any reason they cannot make them, they should work in cooperation first with their correspondents, and if they cannot make it in combination, should work with the bank credit groups which have been formed for this purpose. If for any reason there are loans that are not or cannot be made through these sources, means have already been provided under section 13B of the Federal Reserve Act in a limited way. The provisions of this section might be amplified and some of the restrictions removed. With some changes the pending Wagner-Spence bill might be the solution to this problem. With this array of credit facilities available, no competent borrower should suffer for the want of a proper loan. I, therefore, see no reason for



the addition of any other governmental agency to enter into competition with these existing facilities.

Mr. GIFFORD. Mr. Folsom?

Mr. FOLSOM. Mr. Steinmetz, has your experience been mostly with smaller companies or larger companies?

Mr. STEINMETZ. Mostly with smaller companies, Mr. Folsom. We are definitely a neighborhood bank.

Mr. FOLSOM. You mentioned the border-line case of the companies who require really equity capital, as to whether the banks could really get into that field or not.

Do you think there is any need for any organization which might supply that equity capital, or help supply that equity capital, to the small firms who can't go into the investment market?

Mr. STEINMETZ. I think there is a definite need to supply that type of capital. I indicated that I think the whole thing is quite obscure. I think it ought to be gone into by the interested groups and a plan worked out.

I think I could illustrate it with a personal experience which we had recently. It doesn't just fit this particular case, but it is indicative of the kind of loan that you run into. It was a family-owned business. One interest of the family wanted to withdraw. The question came up as to how the remaining interests should finance the purchase of the other interest. In this particular case there were financial means enough in the other interests to have done the job by themselves. I mention this only because it shows the angles you get into. Very often they are not able to do it. It wasn't large enough for the public to be interested in a minority interest. We worked out with them what we thought was a satisfactory approach by using the credit of the individuals. When their accountant was called in to consider it he pointed out to them that by the time the corporation got through paying its taxes and then had to pay a dividend on the stock and the individual holders of the stock that had been purchased paid their tax on the dividend there would be very little left for the new purchasers to pay their loan.

Well, the result was that he suggested, whether rightly or wrongly, if the company purchased a portion of the stock, they would avoid that one step of taxation and be able to retire the debt a whole lot quicker than if it had gone through the proper process of taxation. I mention this to indicate that tax laws result in peculiar methods of financing.

The other thing that you constantly run into is a request for a loan from the little fellow in the neighborhood who has been the foreman or superintendent for a manufacturing concern and has toiled away for many years and thinks he ought to use the knowledge he has acquired by getting into business for himself. He has a very modest amount of savings. It is hard in these days for him to do it. He comes in and says, "I have the ability and I have a few dollars. Won't you help me get into business or won't you help me purchase a business already in existence?"

They are definitely equity-capital loans. There have not been in our banking system the means to make these loans except in the case when a neighborhood bank does it on a strictly character basis, as I have tried to indicate.

We know this fellow and we know he has the know-how and that he is honest, but sometimes it takes considerably more money than a fellow can save to get into an individual business.

I submit to you gentlemen in the period prior to our getting into the depression a great many of the now large businesses were the result of just those small beginnings. We did not have the entanglements that we now have, and we fellows in the neighborhood, as I say, financed those fellows to a degree, but there is always a limit beyond which we cannot go.

Mr. FOLSOM. Will these bank pools help that situation any?

Mr. STEINMETZ. I think to some degree they will. I am not one of those who believes that these credit pools are just make-believe things. I happen to be on the committee of the Philadelphia group and I know the feeling of that group is that we are going to make loans even though we are going to take losses. We recognize the responsibility to the community we serve.

Mr. FOLSOM. Are you familiar with the plan that was proposed a day or two ago before this committee by a committee from the Investment Bankers Association of setting up these local companies to divide equity capital to small companies?

Mr. STEINMETZ. I read it coming down on the train.

Mr. FOLSOM. Do you think there is need for some kind of organization like that?

Mr. STEINMETZ. I think there is need for something in that area. Whether it should take that form I should rather like to study and express an opinion after having done so.

Mr. FOLSOM. That is all I have.

Dr. KAPLAN. Mr. Steinmetz, you have indicated that short of out-and-out equity capital the banks can go into the field of lending working capital for equipment and expansion so long as the banks can see how it may be liquidated over a term of years. It has been suggested that the banks don't feel that they can take very much of that kind of capital because it might affect the liquidity of the banks, and there have been some complaints that the banks aren't liberal enough in considering loans of that sort.

The suggestion, therefore, has been made that it might tend to make the banks more liberal in their loans if some sort of insurance scheme, and FHA and FDIC has been decided, might be developed out of which it might be possible to take care of a part of the losses of the bankers on risk loans.

Would you mind indicating what you as a banker might think would be the possibilities or limitations of an insurance plan to liberalize your lending for working-capital purposes?

Mr. STEINMETZ. Dr. Kaplan, this question of insurance always intrigues me. I have been accused at times of being a rugged individualist. Sometimes I like it and sometimes I don't. There are times when we ought to act independently. There are times when the public interest is at stake when we ought to act cooperatively.

My own experience with insurance, and here is where I may be shot, has been that whenever you attach insurance to something you attempt to protect yourself against loss. The result is that there is a tightening up in the process because the supervisory authorities of any insurance program are just as anxious as anyone else to make a record

for themselves and the result is that in a desire to save somebody from loss there is a tightening up of the market for the use of money.

Now I think the answer to the situation, instead of attempting to protect us against loss is to recognize that there are certain calculated risks necessary. If in doing that we in effect do what the insurance people do, and we know what they do, we reinsure. Why reinsure? Why don't we take those loans cooperatively in the first place, recognizing the risk and sharing the risk with the idea that any one of us could stand the shock of whatever that calculated risk may be?

Mr. GIFFORD. I would like to ask one question, and then I am going to ask Mr. Fogarty to take my place.

What percentage would you tell us you have invested of your depositors' money in Government bonds?

Mr. STEINMETZ. We have no guaranteed obligations. We prefer to buy the direct obligations.

Mr. GIFFORD. What percentage is that?

Mr. STEINMETZ. We have some 80 percent of those. I am not too proud of it. I should like to make as a supplementary statement to that I think there is too much emphasis being placed on liquidity. I am afraid when we are too liquid we are not functioning too well.

Mr. GIFFORD. In the statement of my bank it was interesting to note how the percentage had increased. They have gotten up to 80 percent. If money is needed and you have invested it in Government securities, what are you going to do, are those Government securities frozen, or would you easily transfer them and get money?

Mr. STEINMETZ. I don't think that presents as serious a problem as some people think.

Mr. GIFFORD. I don't know that it does. I am asking you what you would do. You need more than 20 percent for your customers, don't you?

Mr. STEINMETZ. I hope we do, and I believe we will.

Mr. GIFFORD. If you needed more, what would you do?

Mr. STEINMETZ. We would get rid of our Government securities and make loans to enterprises in the community.

Mr. GIFFORD. How would you get rid of them?

Mr. STEINMETZ. We would sell them.

Mr. GIFFORD. To the public?

Mr. STEINMETZ. We would have to sell them in the public market.

Mr. GIFFORD. Wouldn't the Federal Reserve take them at par?

Mr. STEINMETZ. The Federal Reserve would lend against them at par, but it is a question whether we should pay them a rediscount rate when we could sell them in the open market and replace them with another loan. A great deal of that would depend upon whether the situation was temporary or whether it was long term.

Mr. GIFFORD. A great volume of it is going to be needed. If there is any great volume you will have difficulty disposing of it. The Congress provided to lend to you at par at a small rediscount rate. You probably would rediscount them with the Federal Reserve, wouldn't you?

Mr. STEINMETZ. I think temporarily that may be true. Over the long term I am afraid it would not be true.

There is generally aversion on the part of bankers, largely as a result of public criticism, to showing bills payable on their statements.

Mr. GIFFORD. How much in bonds is now cashable?



Mr. STEINMETZ. I don't know the exact figure. Of course, there are a lot of demand obligations of the Government.

Mr. GIFFORD. There are \$36,000,000,000 as I am informed. \$26,000,000,000 I was informed here is in their pockets. That seems to be a lot of money.

Mr. STEINMETZ. If by chance the public wanted their money and the Government had to revert to other means of getting its money, the result would be increased deposits, and, therefore, increased funds available for the banks.

Mr. GIFFORD. We have created this money by debt. If I gave you my note for a thousand dollars and got the cash, you would be creating that \$1,000.

Mr. STEINMETZ. Yes.

Mr. GIFFORD. There is no question but the Government has done it. The debt, in going up to \$300,000,000,000, is creating money.

Mr. STEINMETZ. There is no question but that the present liquidity is a result of that process of creating deposits. There being no other place to put the money, we put it in bonds, and that is the reason our Government percentage is as high as it is today. Where else could we put it? We have knocked the bushes for loans through this period, and they are not available in proportion to our deposits.

Mr. GIFFORD. The idea back of it all is that you have money to loan me to buy bonds with but little money to loan me on risk capital.

Mr. STEINMETZ. I would not agree with you as far as our bank is concerned. We will greet you with open arms.

Mr. GIFFORD. I will come up to see you. [Laughter.]

I would like for this to go off the record.

(Discussion held off the record.)

Dr. KAPLAN. Have you wound up your summation of the question of insurance and its applicability to the bankers' problem?

Mr. STEINMETZ. I think I have. Have I answered it to your satisfaction?

Dr. KAPLAN. I merely wanted to get on the record your view, as a banker, as to whether that is a device you would look to.

Mr. STEINMETZ. Maybe I could emphasize a little more the point you are trying to make. In saying this, I have no fault to find with the procedure set up within the banking system to date.

Let me try to illustrate the point I am attempting to make. You have at least four supervising organizations in the banking business today to make sure that we don't make bum loans. Each one of these is jealous of his own organization. You came along with the FDIC and I have no fault with the principle involved. It served a very desirable purpose at a desirable time. But if in a desire to make their banks so safe that no depositor loses money, they enter into competition on the supervising examining side with the other agencies who are just as jealous to see the banks under their supervision are so clean, aren't you defeating the purpose of one of the main functions of the bank, that is, making the loan which at some time may be a risk loan? Isn't it logical that would cause a tightening up?

Therefore, I conclude that when you attempt to insure the natural result is that the fellow who is put in charge of that insurance organization is out to make a record for himself and you get a tightening process when what you ought to get is loosening process.



I don't mean to get out of bounds. I mean that it isn't logical that a fellow who is supposed to see that you are so clean that you don't make a loss is going to be derelict in the performance of his duty. There is a natural tendency to tighten up by that process.

Dr. KAPLAN. Does that apply to guaranty of loans?

Mr. STEINMETZ. Lloyd's of London, don't call their policies insurance policies. They call them guarantee bonds. I should like to know the difference between an insurance policy to protect you against loss and a guarantee. I think they are the same thing. They are called by different names. I think the sharing of the risk is the better approach, and I think there is ability and willingness by the banks to do this job.

I have tried to indicate that if they can't do it, there are already sufficient means for us to do it with some liberalization. Now give us an opportunity to do that job.

Dr. KAPLAN. Where will the motivation come for that liberalization?

Mr. STEINMETZ. It has to come from where the demand will arise. I think we already see evidence that there is a demand for this, and I think the attempt on the part of the legislative bodies to offer a solution to this thing is an indication that the public is already demanding something of that sort.

I think, as I say, an enlightened self-interest on the part of the bankers indicates that they are getting—and undoubtedly acting in accordance with what they are getting—that feel of the thing, and are approaching it with the idea of trying to supply that need.

Mr. LEFEVRE. What are the four agencies you have referred to?

Mr. STEINMETZ. You have the Comptroller of Currency examining organization; you have the Federal Reserve System examining organization. You have the various State bank examining forces and you have the FDIC. As I have indicated, I think it is logical that each organization wants its group of banks to appear to be the best banks.

Mr. FOLSOM. But each bank doesn't have that many examinations.

Mr. STEINMETZ. Oh, no. You see, each organization builds up a table showing the banks under its supervision and the liquidity of them as compared with the liquidity of other banks, and the competition grows.

Mr. SIMPSON. Do you think you have too much Government supervision?

Mr. STEINMETZ. Frankly, yes.

As I indicated to you before, I am accused of being a rugged individualist. I am just as jealous about doing my job, whether I am supervised or not. I am accountable to people who deposit their money with my bank and I am accountable to our stockholders, and if I discharge that duty well, then I don't need supervision.

Mr. SIMPSON. Doesn't your bank stand ready to make a loan to any individual or any small business corporation that is entitled to it, regardless of Government help?

Mr. STEINMETZ. Yes, sir. As a matter of fact, we have made loans in this war period without resorting to Regulation V, on a basis that if they were good enough for somebody to guarantee, they were good enough for us to make. We knew the individuals, and we knew they could produce goods and, after all, what we were lending against were

Government accounts receivable that were coming into being. We knew they would get into the accounts receivable state and all we had to do was finance them to that stage. We knew when the account was paid, the customers would pay their loans.

Mr. SIMPSON. What do you consider, as a banker, the difference between a small retail merchant and a small business?

Personally it seems to me that here in Washington, with the different committees handling and investigating the small business, they do not separate the two agencies. I mean by that a retail business and a small factory employing 100 people or more. I think the issue is confused here.

Mr. STEINMETZ. I think it is confused everywhere.

We have attempted—I am referring now to the cooperative study that the Robert Morris Associates have made in conjunction with the Reserve system—to get some information about all classes, manufacturing companies, wholesale trade companies, and retail trade companies.

Well now, when you get down into the retail trade group you have the neighborhood corner store. When you talk in terms of millions of businesses, I am afraid sometimes we talk about small business and use these figures to emphasize the numbers. Now they are with you and now they are not. They come and go. You have the neighborhood merchant who has been there for years and maybe his family before him. They present no problem. But you have the fellow who comes into the neighborhood who is entirely a stranger and starts up a business, and I think if we were to check the statistical record, we would find that at least 80 percent of these are doomed to failure when they start, either due to lack of capital or lack of capacity. Yes, when we build up the figures, we talk about those things rather glibly as representing a picture, and we build a strong case.

I don't think personally, that small business where you have confidence in management is at present too bad off or has ever been too bad off. Now it is true that in the early period of the war effort a case can be built up that there was a lag. It is natural that there should have been a lag in the flowing of that business to the smaller fellow, because in an emergency situation it is logical for the services to go to the fellows who have the know-how, or who could get going faster because of their organization. Our study indicates that after about a year that lag caught up, and the speed with which the small business went was at a greatly more accelerated pace than it was with large business.

That is a condition that usually exists. I think the research organizations of the larger companies keep them more closely in touch with markets, and they can do more anticipating than the smaller fellow can.

I think we sometimes lose sight of the fact that small business could not be prosperous unless large business is prosperous and that we should not necessarily put a penalty on being big. If big business is prosperous, usually small business has a degree of prosperity. Certainly, one is so much dependent on the other that we ought to think of them in terms of being correlated.

Mr. LEFEVRE. What is the rediscount rate charged by the Federal Reserve banks?

Mr. STEINMETZ. I am sorry, but I haven't availed myself of it. I see some Federal Reserve men over there. Probaby they could tell us. It is so low that we don't even worry about it.

Mr. SIENKIEWICZ. It is one-half percent on Government short maturity.

Mr. STEINMETZ. What about the longer maturity? Of course we are not allowed to handle those. It is purely academic.

Mr. SIENKIEWICZ. One percent over a year.

Mr. STEINMETZ. I thought that was it, but I didn't want to say so, because I was not sure.

Mr. FOGARTY. Dr. Kaplan, do you have any more questions?

Dr. KAPLAN. No.

Mr. FOGARTY. Mr. Simpson?

Mr. SIMPSON. No.

Mr. FOGARTY. Mr. LeFevre?

Mr. LEFEVRE. No.

Mr. FOGARTY. Mr. Folsom?

Mr. FOLSOM. No.

Mr. FOGARTY. Thank you very much, Mr. Steinmetz. We appreciate your coming down here.

Mr. STEINMETZ. Thank you for your courtesy.

Mr. FOGARTY. We will adjourn until tomorrow morning at 10 o'clock.

(Whereupon, at 11:55 a. m., the committee adjourned to reconvene Friday, April 27, 1945, at 10 a. m.)





# POSTWAR ECONOMIC POLICY AND PLANNING

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FRIDAY, APRIL 27, 1945

HOUSE OF REPRESENTATIVES,  
SPECIAL COMMITTEE ON  
POSTWAR ECONOMIC POLICY AND PLANNING,  
*Washington, D. C.*

The special committee met, pursuant to adjournment, at 10 a. m., in room 1012, New House Office Building, Hon. William M. Colmer (chairman) presiding.

Present: Representatives Colmer (chairman), Gifford, Welch, LeFevre, Zimmerman, Lynch, Simpson, and Voorhis.

Also present: M. B. Folsom, staff director; H. B. Arthur, consultant; A. D. H. Kaplan, consultant; and C. A. Sienkiewicz, consultant.

The CHAIRMAN. The committee will please come to order.

We have called this session to hear Mr. Emil Schram, president of the New York Stock Exchange, and we are going to turn the time over to you, Mr. Schram. You may use it as you see fit. I assume you have a statement?

## STATEMENT OF EMIL SCHRAM, PRESIDENT OF THE NEW YORK STOCK EXCHANGE

Mr. SCHRAM. Mr. Chairman, I have a very short statement here which will take about 7 or 8 minutes to read, and then I hope, possibly, that will suggest some questions that I will be glad to answer if I possibly can.

The CHAIRMAN. I am sure it will.

Mr. SCHRAM. It is most gratifying to me, and I am sure to the representatives of business generally, that this able committee is addressing itself to the problems of the approaching transition and the early postwar period. I welcome the opportunity to offer some comments and observations, particularly as to the role of the securities markets in facilitating the flow of capital into industry.

As we emerge from war to a peacetime economy, the problems of readjustment will demand the same type of unity which has developed in the prosecution of the war and will require managerial skill and resourcefulness equal to those which are being applied in winning the war. Obviously, in the course of readjustment the transfer of personnel and equipment from various types of production to other types will necessitate the employment not only of short-term capital which may be obtained through the usual banking channels, but also long-term capital which can best be procured through recapitalization and the issuance of additional equity and debt securities.

It is impossible to predict how many billions of dollars will be required, but we do know that the demand will be of large proportions. Indeed, we may expect that the total of capital requirements will far exceed anything hitherto known in industry.

Of one thing there seems to be no possible doubt—that the vast reservoirs of private funds built up over the past several years are awaiting an attractive outlet for investment and, irrespective of Government subsidies, the demand for the investment of venture capital will be great and will afford the most logical and, in the long run, the most economical method by which this capital financing may be accomplished.

It should be kept in mind in this connection that the wealth of individuals in the form of cash, Government bonds, debt and equity securities, and other liquid assets, has reached the highest point in history. For instance, as of June 30, 1944, the holdings by individuals of cash and deposits were in excess of \$84,000,000,000 and of United States Government securities over \$46,000,000,000. On the other hand, while industrial net earnings, before taxes, have for the most part been the highest in history, various tax and other restraints upon the accumulation of surpluses by corporations necessitated by the demands of a war economy have left industry facing the need for additional capital for reconversion and postwar purposes.

It would seem appropriate at this point to add that I agree with the propositions stated in the fourth report of your committee, from which I am pleased to quote:

Partly as a result of the prewar trend and partly due to wartime necessities, the Federal tax system has placed steadily increasing burdens on risk-taking enterprise. On the one hand, it puts a premium on the avoidance of risk provided by the refuge from taxation through tax-exempt securities. On the other hand, it has imposed double taxation on income derived from business dividends and has placed excessive burdens on those businesses and individuals to whom we must look for a large share of the funds required for the expansion of employment opportunities. An adequate reduction in such tax burdens is essential. \* \* \*

This, it would seem to me, should be one of the first considerations with respect to the needs of business during the transition and early postwar period. This would provide the incentive for, or at least remove the deterrent to, the flow of our vast individual wealth into the channels of industry through capital investment.

The function of the exchange and other securities markets is to provide a market for the securities which grow out of the capitalization or recapitalization of the issuing companies, after their primary distribution to the public. The ultimate possibility of such securities finding a free and open liquid market for their sale is an essential consideration to both the companies and those that handle their financing.

This is of particular importance as applied to the problem of postwar financing because most of such financing will involve existing companies whose present debt and equity securities are already widely distributed among the public and are dealt in on the various securities markets. In other words, the demand will be for investment to finance new enterprises of established business rather than brand-new ventures.

Every encouragement must be given, therefore, to that freedom of action which is provided by the stock markets; in other words, so that the demands for new capital may have all of the advantages of marketability.

Coming now specifically to the extension of trading facilities to a larger number of securities and the consequent facilitation of the flow of capital to business enterprises, the answer, based upon long experience, is that people are unwilling to invest in securities unless there is a ready, adequate market. It is axiomatic that the willingness to risk bears a direct relationship to the ability to limit loss, on the one hand, and to realize profit on the other. The marketability provided by a securities market such as ours is necessary, therefore, to the flow of capital into business enterprises.

However, we feel strongly that such extension of trading facilities must not be accompanied by any relaxation of the underlying requirements of the various exchanges. These have been designed to provide a maximum of protection to the investing public; and while some phases of regulation of the financial markets in recent years have unnecessarily interfered with the free flow of venture capital, the effect of regulation, in the main, has been most beneficial. Some revision of the Securities Act of 1933 and the Securities Exchange Act of 1934 is undoubtedly desirable. It would be disingenuous to contend that the more than 10 years of experience with the acts has not given evidence of the need for some revision.

A complete discussion of such revision would require an exhaustive analysis and far more of this committee's time than is available. The most important revisions which those in the securities industry have indicated to be desirable and necessary may be summarized as follows:

Certainly any revision of the securities acts should seek only to make these statutes more workable; and, in modifying their provisions governing procedures, the purpose should be to make it possible to transact business more efficiently without impairing in any way the protection afforded to investors.

The proposals of the securities industry with respect to the Securities Act of 1933 have been chiefly concerned with the following problems:

1. The use of information prior to and after the effective date of a registration statement;
2. The requirements as to the use and delivery of prospectuses;
3. Simplification of registration procedure;
4. The exemption of small issues and of certain classes of issuers and of transactions from the registration procedure but not from the fraud provisions of the act;
5. The bases of liability under section 12 with respect to the dissemination of information relating to securities already outstanding in the hands of the public;
6. The scope of the registration requirements of the act as determined by the meaning of the term "public offering"; and
7. The size and organization of the Commission itself and the general administration of the act.

The proposals by the representatives of the securities industry with respect to the Securities Exchange Act of 1934 were made with a view to permitting the more efficient functioning of the Nation's securities



markets without impairing in any way the protection afforded to investors by the provisions of the act. These proposals of the industry have been chiefly concerned with the following problems:

1. The scope of the provisions of the Exchange Act.
2. Simplification and clarification of the registration process.
3. Elimination of the threat of segregation.
4. Extension of credit on new issues.

These matters are dealt with in greater detail in the attached foreword to the report on the conferences with the Securities and Exchange Commission and its staff by representatives of the Investment Bankers Association of America, National Association of Securities Dealers, Inc., New York Curb Exchange, and New York Stock Exchange, dated July 30, 1941. (See exhibit No. 2, p. 2498.)

To sum up regarding possible changes in Government regulations and exchange rules, I would advocate as a statement of basic policy that it would best serve the interests of our economy, and therefore the facilitation of the flow of capital to industry, to permit the greatest degree of freedom and self-regulation consistent with the prevention of fraud and the principle of the disclosure of material information.

As to what facilities are necessary to supply capital to businesses that do not have access to organized security markets, this is something which perhaps those representing the commercial and investment bankers are better qualified to comment upon. The needs of small business will be perhaps proportionately greater than the requirements of the large, well-capitalized corporation. Provision should be made to take care of these needs.

Suggestions have already been made to your committee which would appear to be practical and constructive. I might say that it is obviously of the utmost importance that those who will be called upon to furnish capital be assured that the various controls which have been accepted as an integral part of our national policy for the duration of the war-created emergency are temporary and will be relaxed as soon as conditions permit. Similarly it is of the utmost importance that the policy of Congress with respect to tax revision be made known as soon as possible, so that corporate enterprise, both large and small, may be in a position to plan its postwar programs and determine its postwar requirements.

In conclusion, may I say that I have every confidence in the ability of business to cope with the numerous problems of the postwar period to come. However, the celerity with which these problems may be solved will depend in large measure upon the preparations which are made now for their solution. Your committee has the opportunity to contribute greatly to these preparations. I am sure that out of your hearings will come recommendations which will go a long way toward assuring success in the postwar period.

The CHAIRMAN. Does that complete your statement, Mr. Schram?

Mr. SCHRAM. That completes my statement; yes. I will not read the foreword.

The CHAIRMAN. We are going to depart from the usual procedure here this morning and are going to give the honor and distinction of propounding the first questions to the witness—to the witness' Member of Congress, Mr. Simpson.



Mr. SIMPSON. Mr. Chairman, I appreciate your departure from custom and regular procedure in asking me, a new member of the committee, to interrogate Mr. Schram in the first instance.

Mr. Schram and his family really belong to Greene County, Ill., having farmed there for the past 25 years. We regret the fact that we have had to share him with Washington, New York, and Indiana, for the past 12 years.

I feel more qualified to interrogate him on agricultural subjects than on postwar proceedings of the stock exchange. I feel a little out of order in propounding questions along that line. If the questions pertained to a hog or a bushel of corn, I would get along a little better. However, I will ask one or two questions.

Yesterday, Mr. Folger, president of the Investment Bankers Association, made the statement that in his opinion the Securities and Exchange Commission should be more concerned in having savings go into business rather than with the functions of regulation. Would you care to make any statement or give your own views on that matter?

Mr. SCHRAM. Well, of course, it is the job of the Securities and Exchange Commission to regulate the securities industry, and unquestionably through proper regulation they could encourage savings to go into business.

I do not know just what Mr. Folger has in mind there. I do not see how they could ignore their duties of regulation. I think that is the whole basis for the act; that is what they are set up to do. But I think through regulation they could be helpful in facilitating the flow of savings into business.

Mr. SIMPSON. The only other question, Mr. Chairman, is this: Since coming to Washington 2 years ago, and being a small businessman myself, I think the issue of small business is confused. I think it is confused in the papers and with the public and generally, I think, with the Congress.

Normally I think here you set a figure for a small businessman as the owner of a factory employing 50 or 100 people, or less. I have not seen anything pertaining to the small retail country merchant. I think there should be a definite and distinct difference between the small retail merchant and the small manufacturer. I just wanted to put that in the record, and that is all of the questions I have.

The CHAIRMAN. Mr. Zimmerman, did you have some questions?

Mr. ZIMMERMAN. I regret very much I did not get here to hear Mr. Schram's statement, and for that reason I could hardly presume to ask any questions.

The CHAIRMAN. Mr. Gifford, do you have some questions you would like to propound to Mr. Schram?

Mr. GIFFORD. I do not know whether I know enough about it, but I am interested in the statement of Mr. Eccles, of the Federal Reserve, recommending a 90-percent tax on profits within 1 year.

Are you acquainted with that proposal, Mr. Schram?

Mr. SCHRAM. Yes; I am.

Mr. GIFFORD. It affects my real-estate business; does it affect the people who buy and sell stocks?

Mr. SCHRAM. Very much so, Mr. Congressman.

Mr. GIFFORD. What is the latest development; to whom has he made that recommendation?

Mr. SCHRAM. I think he made the recommendation to Congress. I think he made the statement before the Banking and Currency Committee. It was some time ago.

Mr. GIFFORD. Could he go to the President and get a directive to that effect?

Mr. SCHRAM. No; I do not think so. I think that would have to be done by legislation; that Congress would have to change the capital gains tax, because that is in the tax structure.

Mr. GIFFORD. It is a little different from the general regulation, because it has a definite amount. Do you think the Ways and Means Committee would have to pass on that 90 percent?

Mr. SCHRAM. There is no doubt in my mind they would have to pass on it.

Mr. GIFFORD. It is 25 percent on profit now, is it not?

Mr. SCHRAM. For the long-term period; that is, after an asset has been held for 6 months.

Mr. GIFFORD. In the trading of stocks on the exchange, what is the rate of tax?

Mr. SCHRAM. It is the same; 25 percent on assets held for 6 months or more, and up to 6 months it is the short-term gain and is taxed at the normal rate, whatever bracket you may be in.

Mr. GIFFORD. What would be the effect on investment if you had a 50- or 60-percent tax on short-term gains of 1 year, say?

Mr. SCHRAM. I think it would have a very serious effect. I am not at all in favor of Mr. Eccles' proposal. I am in favor of his objective.

Mr. GIFFORD. What is his objective?

Mr. SCHRAM. His objective is to prevent inflation and to cut down rising prices or increasing values. I think that his proposal will have just the opposite effect. I am in favor of doing everything we possibly can to prevent inflation, but there is no doubt in my mind what he proposes to do will have just the opposite effect.

Mr. GIFFORD. He would not care to make good anyone's losses.

Mr. SCHRAM. I have no doubt he would not.

Mr. GIFFORD. No Government agency is interested particularly in your losses.

Mr. SCHRAM. No. The gains are taxed, but the losses are not deductible, except to the extent of \$1,000 a year, which can be carried forward for 5 years.

Mr. GIFFORD. You say this committee will probably be able to make recommendations which will have some force and effect; so I was interested as to what your suggestion would be, especially relating to the Securities and Exchange Commission. Like other agencies, we set them up and then forget they are there and let them go on without any particular review.

The Interstate and Foreign Commerce Committee claims it has more or less review on them, but I do not think very much is done along that line.

How much exemption would you recommend or have you recommended?

Mr. SCHRAM. I think 3 years ago we recommended up to \$300,000—no; we recommended \$500,000, and it is \$300,000 now.

Mr. GIFFORD. What have you to say about concerns which sit down with insurance companies and other people who have money to invest and where the investing is done over the table and does not go through usual channels?

Mr. SCHRAM. Do you mean selling direct?

Mr. GIFFORD. Yes.

Mr. SCHRAM. Well, insurance companies, of course, are in great need of that type of security, and by necessity they must invest in what we know as sheltered funds; and they take up their big blocks of securities with, I suppose, a much better price than they could be sold to the public, because they do not have the selling cost. I imagine if they were put out at competitive bidding the insurance companies would buy them anyway, because I think there is a shortage of securities that insurance companies can invest in now.

Mr. GIFFORD. They avoid expense, but people in the investment business lose the market in their business?

Mr. SCHRAM. To some extent.

Mr. GIFFORD. You do not think that is harmful?

Mr. SCHRAM. As I say, the chances are they would buy them anyway in the competitive market.

Mr. GIFFORD. Mr. Schram, do you not object strenuously to this matter of having to prove yourself honest before you can proceed? Is that a theory which is necessary in the administration of the Securities and Exchange Commission? Can they not wait until a complaint has been presented and then ask for an adjudication? Is it not enough to clothe any bureau with police power without clothing them with power to make Jerry Voorhis prove he is honest when we all know that he is?

Mr. SCHRAM. I have always worked on the theory that a man is honest until he proves himself dishonest.

Mr. GIFFORD. Do you not think our Government has departed from that theory?

Mr. SCHRAM. I think there has been a trend in that direction.

Mr. GIFFORD. Particularly in the matter of the Securities and Exchange Act?

Mr. SCHRAM. I have loaned lots of money for the Government and I have come to have great respect for the integrity and honesty of the American people. In all of our Reconstruction Finance Corporation experience it has been amazing to me we have been able to lend the money we did there and the way it has been paid back is remarkable. That proves to me you have every right to have confidence in the honesty and integrity of the American people, and I think we make no mistake by assuming that people are honest and that you will find a very small percentage are dishonest.

Mr. GIFFORD. Do you consider it has been a good thing in a country district like mine, where there are a lot of people each having a small amount of money to invest? They have been accustomed to have someone act as adviser and tell them what to invest in. Those men seem to have disappeared; do you know for what reason?

Mr. SCHRAM. You mean people they can go to and ask about investments?

Mr. GIFFORD. Yes.

Mr. SCHRAM. I did not know those people were going out of business, but if that is true, it is certainly a sad commentary, because I have been trying ever since I have been with the Exchange to encourage people to know more about securities.

Mr. GIFFORD. Suppose they asked for a prospectus; would the ordinary investor be able to get the actual truth from that prospectus, or would that prospectus be so voluminous he would not read it?

Mr. SCHRAM. I think the latter is true. I think it is awfully hard for the average investor to take a prospectus and find out what is in it. There is a lot of stuff that goes into them that I do not think needs to be in them at all. I do not know what happens when you hand a prospectus to a prospective customer, but I have often wondered if he does not think the prospectus which has been cleared through the Securities and Exchange Commission does not mean it has been given the stamp of approval on the part of the United States Government of that particular security.

We, those of us who know what a prospectus is, know that it has not had that stamp of approval, but I have often wondered if it has not had a wrong effect on the more or less uninformed purchaser and that he looks at that prospectus and says, "The SEC has passed on that and I guess it is all right to buy." Of course, it only sets out the facts regarding the company, and the prospective purchaser is supposed to make up his own mind.

Mr. GIFFORD. We feel the prospectus does carry with it an assurance that the Government itself says it is all right, when we know, of course, he has simply answered what the governmental regulations require as to its form. The law would be fairly satisfactory if it was administered a little differently, perhaps. Is that right?

Mr. SCHRAM. Of course, good administration helps any law, Mr. Gifford, and, of course, it is impossible for Congress, when it passes an act, to write in the administration.

Mr. GIFFORD. I wish my constituents could hear you say that.

Mr. SCHRAM. Sir?

Mr. GIFFORD. I wish my constituents could listen to you saying that.

Mr. SCHRAM. Congress can pass the laws, but if they are improperly administered, they do not do much good, and we should all constantly point to better administration of the laws on the books. A very good law can be ruined by poor administration.

Mr. GIFFORD. That law is best that is administered best. You have heard that old saying probably in school.

Mr. SCHRAM. Correct.

Mr. GIFFORD. But it seems to me of late years in making the country over, we have to administer things very liberally.

Mr. SCHRAM. We very often get into the realm of trying to administer an act—you get into the realm of what was the intent of Congress, and that is why I think it is most important that whenever Congress has the time, they should certainly look into the securities acts because perhaps there was an intent of Congress years ago when they were passed that may not be the same today.

Mr. GIFFORD. Were you connected with the administration of the Securities & Exchange Act?

Mr. SCHRAM. No. I was with the Reconstruction Finance Corporation then.



Mr. GIFFORD. I was familiar with the administration of the act. Do you remember that Judge Burns was connected with that Commission originally as attorney?

Mr. SCHRAM. Yes; I remember Burns.

Mr. GIFFORD. He afterward became attorney for a private concern.

Mr. SCHRAM. I believe that is right.

Mr. GIFFORD. There seems to be a tendency of people getting out of the Government service and they leave after learning how to take advantage of the Government. Joe Kennedy was called in at first, was he not?

Mr. SCHRAM. He was the first Chairman, I believe.

Mr. GIFFORD. We well remember, when he was called to service, it was because it would make the stock-market people feel better, was it not, to assure them they would have a man who knew the business?

Mr. SCHRAM. I think they wanted someone who knew something about the business.

Mr. GIFFORD. Mr. Henderson was the head of it for awhile, was he not?

Mr. SCHRAM. No. He was on the Commission, but never was Chairman.

Mr. GIFFORD. He was on the Commission?

Mr. SCHRAM. Yes.

Mr. GIFFORD. He would not be on any Commission unless he was very persuasive, would he?

Mr. SCHRAM. I have always found Leon very persuasive.

Mr. GIFFORD. We have always found him so. I told him one day before the Banking and Currency Committee that he had done nothing for 8 years but prosecute and persecute business and how could they have any faith in the administration of the OPA. The TNEC proceedings were more voluminous than I was able to read, but he was executive secretary of the TNEC, was he not?

Mr. SCHRAM. I knew he was connected with it, but I do not recall he was executive secretary.

Mr. GIFFORD. I told him he was very persuasive. I read enough of it to find he did nothing without the viewpoint of getting after business and assuming that all business was crooked. That is the way I felt about it.

But I am trying to go back to the administration of the Securities and Exchange Commission, which was highly important. Joe Kennedy was put in to reassure those people that the Act would be sympathetically understood and administered, and then some others were put on, some who were rather enthusiastic and would let business have a little more confidence.

But I am interested in your suggestion that the Securities and Exchange Act should be reviewed because I know there will be no celerity as long as you have to live up to the regulations. The prospectuses are entirely overdone and are very expensive and do not guarantee anything.

Mr. Chairman, it will be a big job to recommend changes, but something must be done. Many of these agencies must be reviewed after they have been in operation for 10 or 12 years.

Is that correct, Mr. Schram?

Mr. SCHRAM. That is right.

Mr. GIFFORD. You see where they have failed or need attention and sometimes need help, but simply because they are for a good purpose, to prevent fraud, you say you want them to retain all necessary authority to prevent fraud.

Mr. SCHRAM. Absolutely.

Mr. GIFFORD. But what we want is green lights. We do not want a policeman to stand by a traffic light and investigate us before we are able to pass. They want to know your standards 10 or 20 years ago in order to make a present-day decision, and businessmen are required to fill out all of these papers which really are not needed.

Some attorney has to show he is useful in filling these forms or he would not be hired. I do not question the attorneys. I know when I am borrowing money it is amazing to me the number of things that are wrong that my attorney can find; for instance, he will find someone of the heirs of a man who died a hundred years ago—that is what the Government has gotten into; there are too many governmental lawyers and the poor individual knows it and feels he is up against a stone wall.

But we find that the businessmen and the bankers do not dare complain because they would run the risk of punishment, do they not?

Mr. SCHRAM. I think they do.

Mr. GIFFORD. Their better judgment is to say nothing.

Mr. SCHRAM. I am afraid we are getting into that attitude.

Mr. GIFFORD. You are afraid we are?

Mr. SCHRAM. Yes; but I think it is wrong.

Mr. GIFFORD. Well, how do you expect us to help unless the businessmen themselves give it due attention; how do you expect us to do it?

Mr. SCHRAM. Mr. Gifford, in 1941, you will remember the industry, after very long conferences with the Securities and Exchange Commission, came to the Foreign and Interstate Commerce Committee with recommendations for changes in the act. Very lengthy hearings were held at that time, but we have never been able to—the committee has never taken action as a result of those hearings.

Of course, now the make-up of the committee has changed so much that unquestionably they will have to hold hearings again, and I think that should be one of the first jobs of the committee whenever time will permit.

There is no doubt in my mind the SEC will probably welcome that review, and I think perhaps it will be very helpful to them. I think the SEC has a great opportunity to be of service to business in this country and I think they are seeing more and more that they should be helpful, that their job is just a little more than to regulate, that they should really help business, and I think that is true of any Government agency.

Mr. GIFFORD. Has not the stock market for the past several years been regulating itself?

Mr. SCHRAM. It has, for many years.

Mr. GIFFORD. So there is not enough basis for all of this regulation?

Mr. SCHRAM. Mr. Congressman, many of our rules and regulations go beyond the requirements of the act. We think we have done an excellent job in self-regulation, and we think we should be permitted more latitude in self-regulation.

Mr. GIFFORD. As to your last suggestion, the size of the organization and the administration of it, do you mean to cut it down?

Mr. SCHRAM. At that particular time the SEC was overloaded with work and there was some thought there should be some more Commissioners; they did not have quite enough. There are only five Commissioners as compared with the greater number on the Interstate Commerce Commission, and they divide up the work into various sections. We thought possibly it might be helpful in breaking the log jam if they had some more Commissioners to do the job.

At that time there was a tremendous volume of work in connection with reorganization of the utilities and there was an awful lot to do. I do not know what the situation is today, but I think it ought to be looked into. I would be inclined to think that perhaps it is big enough now since a lot of the work is back of them, especially in the utility field.

Mr. GIFFORD. I hope we will get an exemption of at least \$300,000, because when the small man wants to do something very costly, and he has an opportunity to get the money he loses a lot of valuable time before it can go through the Commission.

Mr. SCHRAM. That is right.

Mr. GIFFORD. And that is why you mention celerity.

Mr. SCHRAM. Yes.

Mr. GIFFORD. I do not know very much about this matter but I do know it rests heavily on me and on my friends here, I am sure, when the SEC demands a prospectus and all kinds of information before you can move; they have put so many things in there that no man dare proceed unless he hires a good lawyer, and it furnishes a field for men who have served in the Commission, a good profitable field, and they necessarily are of great advantage to private business.

Mr. SCHRAM. Absolutely.

Mr. GIFFORD. I can name you one or two outstanding cases.

The CHAIRMAN. Mr. Zimmerman.

Mr. ZIMMERMAN. I have been very much interested in the discussion and in the questions propounded by my learned and able friend, Mr. Gifford, whom we all respect—

Mr. GIFFORD. Can I quote you something there? "I can resist all flattery very easily; my spirit rises above it except for one little thing, I love it".

Mr. ZIMMERMAN. I am sure no one wants to flatter my friend; we all concede his talents and ability.

Now, Mr. Schram, I know you have a pretty broad knowledge of business. Your experience has carried you from the grass roots up to the present high position you now occupy. You have been closely related in your work with the RFC to the business of our country for the past several years.

Now, talking about the SEC, I am sure that you recall the necessity for creating that agency.

Mr. SCHRAM. Yes, sir.

Mr. ZIMMERMAN. My friend Gifford has been concerned about business, but there was another side, was there not, Mr. Schram, that called that agency into being, and that was the buying of securities by the public? In other words, in your town and in every city investors in securities—not all insurance companies or big buyers, but a lot of widows and people who have no knowledge of business, were being skinned and robbed and imposed upon, and that called that institution into being, did it not, largely?



Mr. SCHRAM. That is right.

Mr. ZIMMERMAN. Now, your position is you do not want to see it done away with, do you?

Mr. SCHRAM. Oh, no; I should say not.

Mr. ZIMMERMAN. The point you make, and I think we all should approach the subject that way, is that over the period of years it has operated, certain defects have appeared that should be corrected. That is the business of Congress, and Congress should give attention to that, should it not?

Mr. SCHRAM. Absolutely.

Mr. ZIMMERMAN. But I am sure you share the view there is a place in the economic life of this Nation for the SEC.

Mr. SCHRAM. Congressman, I think if anyone attempted to destroy the SEC or to repeal the act, I would hope I would be one of the first ones to come to its defense. I think it is a very good act and it is greatly needed and the very basis of it is really the foundation of the New York Stock Exchange.

We regulate our members; we apply certain requirements to our listed companies; we are very particular about the information they put out and the manner in which they put it out. We want clarity of statement. We require in almost every instance a quarterly rather than an annual statement, and we want it in simple form so that it is readable.

So, the very foundation of the SEC is really the foundation of the New York Stock Exchange.

We believe in regulation, and, as I have said, we regulate our members even beyond the requirements of the act in many instances.

Mr. ZIMMERMAN. I am sure you recognize that in business, industry, and, in fact, in all groups, we have a number of individuals who do not believe in regulation and want to be unbridled and operate in a wild manner as they did at one time in the country's history. I am sure you agree that day has passed and we must have regulation in this complex age in which we live, business, industry, and everything else; we must have fair regulation.

Mr. SCHRAM. I agree with that.

Mr. ZIMMERMAN. Of course, on one side we have business, but there is the public interest on the other side, and sometimes I think their interest may be as great if not greater than that of the business or enterprise that is being regulated.

So, as I take your recommendation, and you say we should make a study of the SEC and if there are things that should be eliminated, do it, and if we should add something, do that; that we should proceed to improve and make it more beneficial, but by all means preserve the institution.

Mr. SCHRAM. I think we all recognize that the securities industry is a very important segment of our economy and that the people in that industry have a great responsibility to the public.

Mr. ZIMMERMAN. That is right.

Mr. SCHRAM. I have been trying awfully hard to point out that responsibility because of their great importance to our economy. I am afraid our businesses would not be able to expand as rapidly as they can now if we did not have a well-regulated exchange upon which securities can be bought and sold, because a man never wants to buy



a security unless he knows there is a ready market for it when he has to sell it, and the man who is the buyer of today immediately is the seller of tomorrow.

So a ready market is a wonderful thing and it does more to enhance the flow of capital than any other business in this country. It is absolutely necessary and, because it is so necessary, we have a great responsibility to the public. We realize that. We are going to continue if you repeal the SEC Act tomorrow, I do not think the New York Stock Exchange would relax its own rules one iota.

Mr. ZIMMERMAN. Your contention is that it has gone even further in regulation than the SEC or other Government agencies?

Mr. SCHRAM. It has in many respects.

Mr. ZIMMERMAN. And you did that because it was necessary for the business in which you were engaged?

Mr. SCHRAM. That is right.

Mr. ZIMMERMAN. For the business itself?

Mr. SCHRAM. That is right.

Mr. ZIMMERMAN. But I think sometimes a lot of us complain and get frightened at regulation. Much is said about it in some fields where maybe it is just something to talk about, but you really lose sight of the importance of the thing that we oftentimes condemn and that is some form of regulation.

Mr. SCHRAM. I do not think there is a market in the world where the investing public has as much protection as they have on the New York Stock Exchange.

Mr. ZIMMERMAN. I understand that.

Mr. SCHRAM. There is no doubt in my mind about that.

Mr. ZIMMERMAN. I am glad to see we do not have any complaints about it any more.

Mr. SCHRAM. I would like you to read my mail, Congressman; I get lots of them.

Mr. ZIMMERMAN. I am more or less in sympathy with the crowd called the public, fellows on the outside who feel the impact of improper management and conduct of some of these great institutions, because, after all, it goes right back to the grass roots and they are the boys who feel it most.

Mr. SCHRAM. We know what the public will do to us if we do not behave.

The CHAIRMAN. Mr. Simpson.

Mr. SIMPSON. In your statement about the widows being skinned, Mr. Zimmerman, you would be willing to add farmers and businessmen of all walks of life, would you not?

Mr. ZIMMERMAN. Yes; I would. I was out in Chicago on some hearings on this marketing committee that has been set up. One of the witnesses pointed out that the owners of stock in a large corporation were practically all widow women who had put their husband's life insurance into it and their future support is in it. He said it is amazing the number of widow women who own that stock.

Mr. SIMPSON. I think that is true. I have a lot of friends who have a lot of cats and dogs in the safety deposit box.

Mr. LEFEVRE. We agree with you, Mr. Zimmerman, but a witness the other day said that 40 percent of the invested capital today is

bypassed entirely because of SEC regulations. Should not something be done to correct that situation, Mr. Schram?

Mr. ZIMMERMAN. I am not opposing correcting things that should be corrected, and I have tried to make that clear. But we do not want to destroy the SEC, and if we can improve it, we should do so; we should try to make it the most workable institution possible in the interest of everybody. That was my idea. I don't know whether I got it over or not.

Mr. LEFEVRE. Yes.

Mr. ZIMMERMAN. I agree with you fully.

Mr. SCHRAM. We have more stocks listed on the New York Stock Exchange than at any time in history. We have made great progress in encouraging companies to list on the exchange. I think that list will continue to grow. I would like to see more and more companies listed because it is of great advantage to the investing public.

Of course, we are not the primary market; we do not list unseasoned securities. Stock does not go on our market until it is well-seasoned and has a wide distribution and a national interest. But I think smaller companies should be encouraged to list on the regional exchanges, the Chicago, San Francisco, Los Angeles—the smaller companies in those particular communities, and as they grow and become larger and have national interest in the stock, then they should come to the New York Stock Exchange, and they usually do when they get big enough. But I think the SEC should constantly encourage listing of securities because you put them in the show windows then; publicity is a wonderful thing.

Mr. LEFEVRE. But that figure of 40 percent being bypassed seems like an awfully large amount.

Mr. SCHRAM. I am not familiar with the figure, but it seems large to me.

Mr. LEFEVRE. That does not seem to help the small investor.

Mr. SCHRAM. I suppose they get that total from a lot of re-funding issues which go directly into the insurance companies.

The CHAIRMAN. Do you have anything further, Mr. LeFevre?

Mr. LEFEVRE. No, sir.

The CHAIRMAN. Mr. Voorhis.

Mr. VOORHIS. Thank you, Mr. Chairman, I want to ask a couple of questions about taxes. First, let me say the only reason I am sorry you are with the New York Stock Exchange, Mr. Schram, is because I wish you were still with the Reconstruction Finance Corporation.

Mr. SCHRAM. Thank you.

Mr. VOORHIS. I want to ask about some of your remarks in here on taxation. In the first place, do you believe there ought not to be any tax-exempt securities?

Mr. SCHRAM. There should be no tax exempt securities?

Mr. VOORHIS. Would you go that far?

Mr. SCHRAM. I do not know why we should have any tax exempt securities. I do not know to just what extent Government securities are taxed. However, I think, that is a question of equalization between the States; it is a terrific problem.

Mr. VOORHIS. I am not saying we could reach it at a bound, but as a matter of practical experience, is that the way it ought to be?

Mr. SCHRAM. I think so; I agree with that.

Mr. VOORHIS. You mentioned double taxation, by which you mean, I assume, the corporation pays a tax on its earnings and, in turn, the individual pays taxes on his individual income on that part of it which is received from dividends from the same corporation. I recognize that problem, but it seems to me if you are going to make a change in that situation, it ought not to be the individual who is relieved, but rather the corporation might have a reduced rate of tax applied to that portion of its income which it pays out of dividends; would you agree with that?

Mr. SCHRAM. Yes, I would.

Mr. VOORHIS. I mean as a method of getting at it?

Mr. SCHRAM. Yes; I do not think you could relieve the individual.

Mr. VOORHIS. No; because, after all, from the point of view of relieving individuals, there is no good reason that dividends received from a corporation by an individual should receive different treatment than income of a person who makes it on salary or in some other way.

Mr. SCHRAM. I am a great believer in the graduated individual income tax, but the reason the corporate tax should be changed is because it is one of the most unfair taxes we levy. We should think of our corporations as businesses owned by thousands and thousands of very small owners, and when you tax this corporation in a very high bracket, you are taxing the individual in the smaller bracket at a very unfair rate.

Mr. VOORHIS. You may be.

Mr. SCHRAM. There is no doubt about it. If you take the widow or orphan who may be in a very small bracket and you are taxing the corporation at a rate of 60 or 65 percent, it is very unfair to put the individual in a 65-percent rate when he or she may be only in a 25-percent bracket.

Mr. VOORHIS. I think you are right. I think the change has to be in the corporation and not the individual tax.

Mr. SCHRAM. Taxes become an item of cost and they must be fed into the cost of the product and I think you get an unbalanced situation when you tax corporations on a different basis. So it makes a lot of sense to me to get that tax from the individual after he receives it and not before, because that is the only way I think you can do it equitably.

Mr. VOORHIS. If we do not have any corporation taxes would you have to boost individual taxes very much?

Mr. SCHRAM. I think the ideal situation is to tax the corporation in the first bracket, the same as you do the individual. There would be some inequalities, but it is impossible to reach perfection in any tax structure.

Mr. VOORHIS. If you are going to make that change in the tax law, do you not think it would be necessary to revive something in the nature of the undistributed earnings tax?

Mr. SCHRAM. I rather doubt that will be necessary. I understand the present section of the act is working very well and they are not having much difficulty with it. I do not think it will be necessary to revive that.

Mr. VOORHIS. Will you not have a certain amount of tax avoidance, a substantial amount over a period of years, in the case of closely held corporations if you do not?



Mr. SCHRAM. There could be, but I do not——

Mr. VOORHIS. Would you not get more and more? If that change is made in the law it seems to me you would give tremendous incentive to that sort of thing.

Mr. SCHRAM. I would like to see it tried without it. If there is a trend in that direction I think it should be stopped, and I think Congress could look at it then. But the old act that was repealed, as I remember it, was very unsatisfactory and very difficult to administer. I think the present one is much better and we are getting along pretty well with it.

Mr. VOORHIS. You mentioned indirectly, at least, the question of incentive taxes; how do you think we could get at that? Do you believe the proposals for so-called incentive taxes——

Mr. SCHRAM. Just what do you mean, Congressman?

Mr. VOORHIS. To vary the rate of tax depending upon what a person uses money for. In other words, if a person uses income merely to sell some securities or buy new ones, or if he uses it on consumption expenditures, the rate would be higher than it would if a person put the money into an enterprise where employment was definitely increased and where it was an actual risk investment in a productive enterprise.

Mr. SCHRAM. Are you talking about the capital gains tax?

Mr. VOORHIS. No, I am talking about the whole tax structure on individual incomes at the moment. I am talking about proposals where if a person spends money to purchase investments, such as bonds or something of that sort, in order to get income, the tax would be at one rate, but where it is an actual risk investment the result of which is to employ additional people and increase the production of goods, you would allow a deduction for money expended in that way from the income-tax basis, or you would vary the rate of tax on the income which might have been expended in that way.

Mr. SCHRAM. No, I do not think that would be necessary.

Mr. VOORHIS. You do not believe in it?

Mr. SCHRAM. I think you could do that by realistic approach to the capital-gains tax problem. I think that would accomplish it.

Mr. VOORHIS. You think that would be all that is necessary?

Mr. SCHRAM. Yes. I do not think it is necessary to allow any deduction for risk investment. I think if you take a realistic approach to the capital-gains structure you will solve the problem and capital will be encouraged to go in.

Mr. VOORHIS. What about a tax—I have never seen the proposition, but have felt it was well worth thinking about—a tax on idle bank balances, hoarded money that is not being used?

Mr. SCHRAM. I think that places a penalty on saving and would be wrong.

Mr. VOORHIS. But they are not active savings.

Mr. SCHRAM. All bank balances must be savings. There I think you inject an incentive—you force a man to do something with his funds which perhaps he thinks is unwise to do.

Mr. VOORHIS. You do not tell him what to do but you show him he cannot leave funds idle without paying a penalty.

Mr. SCHRAM. I think that is putting a penalty on thrift, which I think is bad.



Mr. VOORHIS. Not on thrift, I think, because it could be avoided by any kind of investment.

Mr. SCHRAM. I am afraid I cannot go along with that, Congressman.

Mr. VOORHIS. I was not asking you to go along with it; I asked what you think about it, because that is a part of the incentive tax proposals that have been advanced.

Mr. SCHRAM. Is that so?

Mr. VOORHIS. Yes. If you will expand a little bit on the fourth point of the industry recommendations, namely, the extension of credit on new issues; just what do you mean by that?

Mr. SCHRAM. That is elaborated in this foreword I have submitted. I will read that section:

The representatives of the industry and the Commission are in agreement as to a proposal with respect to the maintenance or extension of credit presented under section 11 (d) at page 215. Today a broker and dealer who has engaged in the distribution of a security as a member of a selling syndicate or group is prohibited for a period of 6 months from extending credit to customers on that security. This has made it difficult for brokers and dealers to extend credit to customers on any securities of an issue which they have distributed. While in some respects the proposed amendment would extend the present prohibition it would limit it to the period during which the broker and dealer is actually distributing a security.

This really pertains to underwriting, the primary market, and the original distribution of the security. It really does not affect the Exchange so much; it does affect our members. It gives a little more liberal treatment under the act. I think the Securities and Exchange Commission will go along with that. I do not think we will have much trouble with it.

Mr. VOORHIS. Thank you very much.

Mr. ZIMMERMAN. I would like to ask a question for information——

The CHAIRMAN. Will you pardon me? We want to bear in mind we have another witness and we hope we will not go into side issues here; but go ahead.

Mr. ZIMMERMAN. I do not know that I quite understood your question a while ago. Did you mean to ask the witness if he believed it would be proper if a man received a dividend from a corporation—and I might be that individual, and I spend that money one way, you will tax me in a certain way? Is that a tax on the manner in which the man spends the money; is that what you had in mind?

Mr. VOORHIS. There have been a number of proposals for incentive taxation which have been sent to all Members of Congress, and I have talked to some of the people who have proposed them. The part of that proposal about which I was questioning Mr. Schram included the idea that when a person was figuring his net taxable income for tax purposes, he would be allowed a deduction of a certain percentage of that income which had been invested. Now, you have got to define investment, and he defined it roughly as the expenditure of money in such a way that employment of labor would be increased by that expenditure.

In other words, an investment in some kind of business which would employ labor, and he was proposing that money so invested, a percentage of that, at least, should be allowed as a deduction from net taxable income.

I was trying to find out what Mr. Schram thought about it. It was not my idea, but someone else's, and I just wanted to get his views.

Mr. ZIMMERMAN. I just wanted to be sure I understood what you were driving at.

Mr. VOORHIS. I am not sure what I think about it. I do not know whether it could be done or whether I would be for it, but I just wanted to know what Mr. Schram thought about it.

Mr. ZIMMERMAN. Yes.

Mr. SCHRAM. Congressman, that money in the bank in the form of a deposit is invested by the bank, too.

Mr. VOORHIS. That is a second question, but that is not the one Mr. Zimmerman was addressing himself to.

The CHAIRMAN. Mr. Folsom.

Mr. FOLSOM. I have just one question. You mentioned that the need of small business for equity capital would probably be proportionately larger than for large business. We had a proposal from the chairman of a small investment banking committee who had been looking into the question of providing equity capital for small business; are you familiar with the proposal outlined of setting up a small organization to provide financing for small business?

Mr. SCHRAM. I am not familiar with the details of the plan but I know that the investment banking group have been working out a program of assisting the smaller businessman. His cost is pretty high and I think they are trying to cut that cost. Whatever they can do in that direction will be very helpful.

Mr. FOLSOM. This plan provides for local capital to put up a certain amount of money for class A stock, and the Federal Reserve bank to furnish money through debentures, and then the borrower would take out class B stock in a certain percentage.

Mr. SCHRAM. I am not familiar with that plan.

Mr. FOLSOM. It would mean bringing the Federal Reserve bank into the picture.

Mr. SCHRAM. That is what I do not like. I would rather see the funds come from private sources. When they come from private sources, a better job of lending is done. You do not always solve the problems of small business by giving it money; it needs more than cash.

Mr. FOLSOM. That is all.

The CHAIRMAN. Mr. Schram, we are very grateful to you for your appearance here this morning and we are sure you have contributed much to these hearings.

Mr. SCHRAM. Thank you very much, sir.

The CHAIRMAN. We have about 30 minutes left and will hear from Mr. Robert M. Hanes, who is president of the Wachovia Bank & Trust Co., of Winston-Salem, N. C.

I observe you have a statement, Mr. Hanes.

Mr. HANES. I have, Mr. Chairman. I thought you could follow the testimony a little easier if it were written out, and if you will permit me, I will read this.

The CHAIRMAN. You may use the time as you see fit.

Mr. HANES. I think we will save time this way.

The CHAIRMAN. You may proceed, Mr. Hanes.

**STATEMENT OF ROBERT M. HANES, PRESIDENT, WACHOVIA BANK & TRUST CO., WINSTON-SALEM, N. C., AND CHAIRMAN, POSTWAR SMALL BUSINESS CREDIT COMMISSION, AMERICAN BANKERS ASSOCIATION**

MR. HANES. I am delighted to have the opportunity to bring before this group banking's record for financing small business during the prewar years and the plans which have already been successfully put into operation for meeting the credit needs of small enterprises in the reconversion and postwar periods.

The growth and prosperity of small business have long been of vital interest to the banks because by far the greater part of the business of all banks is with small enterprises. Banking itself is small business. Approximately 86 percent of the insured commercial banks of the country have deposits of less than \$5,000,000, and the deposits of 43.5 percent are less than \$1,000,000. We know that small business is the backbone and future hope of this country and that it must be perpetuated.

The history of banking shows that banks have frequently been criticized for having made credit too easy, thereby encouraging speculation in real estate, securities, and unsound enterprises. It was only during the latter part of the thirties that banks were criticized because of the belief that they did not make loans freely, particularly to small business.

We as bankers felt that on a Nation-wide basis the banks were making loans and were doing a good job. We realized, however, that this opinion must be supported by factual evidence and accordingly national surveys of bank lending activities were undertaken. The most recent survey, that made in 1940—the last full business year before the war—revealed that the reporting banks handled more than 24,500,000 credit transactions for a total of \$39,000,000,000. This represents about 80,000 credit transactions each banking day. Significant, too, was the fact that this survey proved that the average new loan was \$1,787 and the average renewal was \$1,400. This, we say, is small business.

War brought many curbs on bank credit for general civilian purposes such as the production and distribution of consumer goods. Banking itself, through the American Bankers Association, advocated curtailing loans for other than defense purposes as early as May 1941, and 4 months later the Government adopted a policy restricting bank credit for nonmilitary activities, under what is known as regulation W of the Federal Reserve Board.

During 1942 and 1943 the association conducted an aggressive campaign urging banks to make loans for war production and for essential civilian supply. Many of these loans were made by banks on their own responsibility and without guaranty. Others were made under regulations V, VT, and other forms of Government guaranty or participation. It is indicative of banking's determination to stand on its own feet and make its own loans whenever possible, even in time of war, that reports for as late as June 30, 1944, show that approximately 50 percent of war-production loans made by banks were made without guaranties.



There is another aspect to the effect of war on banking, business, industry, agriculture, and every other segment of our economy which is important and must be considered in postwar plans. War changes nearly all the rules and practices of peacetime operations. The war has been undertaken in America with a great many provisions for the guaranty and insurance of various phases of our domestic economy. Wages, farm prices, cost of production of war goods, the income to holders of War bonds, provisions for the quick settlement of claims against the Government, insurance of war loans made by banks through guaranty and by participation of a number of Federal agencies, have created what might be called a "guaranteed" war, so far as the domestic economy is concerned.

When wartime controls and guaranties are removed and the Government ceases to be the ultimate buyer of a major share of all that the country produces, bankers, farmers, laborers, and businessmen must do everything possible to see that free enterprise is given the opportunity to function for the good of the country and the welfare of the people.

Banking recognizes the necessity of this reconversion and has made definite and practical plans for accomplishing it. These will be outlined in the discussion of the work of the postwar small business credit commission of the American Bankers Association.

There have been such loose thinking and many unsupported statements regarding the amount of credit that will be needed in the postwar period, particularly by small business. Little of this is supported by facts. At the suggestion of bankers the United States Department of Commerce is making a survey of the credit needs of small and intermediate business. This information will not be available for several months.

In considering the postwar credit needs of small enterprises, therefore, we must depend upon reliable peacetime figures. There are many ways of determining the number of business concerns in operation in the United States. We believe the most satisfactory figures are those appearing in Dun & Bradstreet's report of July 1942. At that time their reports showed 2,152,000 active businesses in this country.

These concerns can be broken down into four general classifications, depending on the size of the business as revealed by its net worth. Two of these groups are important for consideration in this memorandum, as they apply to small- and medium-sized business. The first group includes the 1,500,000 concerns which had a net worth of between \$5,000 or less, and the second the 520,000 which had a net worth of between \$5,000 and \$100,000. It is significant in the consideration of the credit problems of small business that the aggregate number of enterprises in these two groups account for all but 132,000 of the over 2,000,000 concerns reported by Dun & Bradstreet.

We believe that there will be ample credit available for the 1,500,000 concerns with a net worth of less than \$5,000. It is unlikely that a loan for any concern in this group will exceed \$5,000. Experience indicates it will run from \$500 to \$2,500. Here it should be kept in mind that because of savings in various forms, a large percentage of this group will be able to do their own financing and will not need credit assistance. However, assuming that half the group, or 750,000, would want to borrow \$5,000 each, the total amount of loans involved would



be \$3,750,000,000, which is considerably less than 10 percent of banking's demonstrated lending record in 1940. The credit needs of this group will provide no problem whatever for the banks.

Nor will the credit needs of the second group, comprising 520,000 businesses with a net worth of between \$5,000 and \$100,000 create any particular problem. The loans for this group would probably average between \$20,000 and \$30,000. Again assuming that 50 percent of the group wanted to borrow \$30,000 each, the amount involved would be \$7,800,000,000, or less than 20 percent of the amount loaned by banks in 1940.

The same type of yardstick can be applied to the remaining two classifications with the same results. The next bracket includes 46,000 firms having a net worth of between \$100,000 and \$1,000,000. The average loan in this group has been estimated to be less than \$250,000. Assuming that half the concerns would want to borrow \$250,000, a total of \$5,750,000,000 in credit would be required, or only about 12 percent of banking's proven lending ability before the war.

Some banks, because of their size, cannot make loans in these larger amounts. This will prove no handicap, however, to enterprise. Effective machinery is already in operation to make possible the smooth flow of bank credit to these intermediate sized concerns. By the operation of the correspondent banking system and through the resources of bank credit groups now being formed throughout the country, adequate credit will be available from one of several sources within the banking structure itself. These additional sources of bank credit will be discussed later in a consideration of the work of the postwar small business credit commission of the American Bankers Association.

Banking is hopeful that the amount of credit required in the postwar period will be far in excess of these estimates. Should this prove true, banking will still be able to make the necessary loans because the resources of the banks today are almost twice as large as they were in 1940.

Without lessening to any degree its maximum contributions toward winning the war, banking has made practical plans for the postwar period. These plans are designed to bridge safely the gap between war activity and peacetime production, and to provide the money that will enable American business, industry, the professions, and agriculture to meet the impact of peace, prepare for new operations, plant expansion, new merchandise and new markets, and to take advantage of the opportunities that will be presented by victorious postwar America.

These plans were developed by the postwar small business credit commission of the American Bankers Association after more than a year's study of the problems of small business by various committees of the association. The commission was organized in July 1944 and is composed of 42 members representing every trade area and all kinds and sizes of banks.

The group early formulated a credit policy and outlined a plan of action that has swept across the country and penetrated to the very grass roots with amazing speed, tremendous enthusiasm, and able accomplishment. Some features of the program are new. However, most of it is designed to adapt prewar credit methods to possible

postwar needs. The commission will assist the commercial banks of the country in resuming the business of making loans for constructive peacetime purposes. Much of the educational program which has been financed by voluntary subscriptions from banks of all sizes is devoted to this purpose.

The fundamental objectives of the postwar small business credit commission is to see that bank credit in adequate amounts and for sufficient lengths of time will be available to any competent man or firm desiring such credit for some constructive purpose that will serve the enterprise economy of our country. This policy was backed by a determined pledge that if the individual banks cannot grant the credit, the bankers will stay with the applicant and see that he gets the money from some other bank or group of banks. American banking will see that small business lives and is given the opportunity to grow and prosper.

The commission made it clear that it did not advocate the making of reckless loans, recognizing that such loans are of no benefit to the borrower, the bank, or the community.

Briefly here is the five-point program of the commission:

(1) Term loans: The principle of term loans developed by banks and used successfully by larger enterprises will be applied to small business. These loans, made for 1 to 10 years under specified conditions, are tailor-made to meet the needs of any particular business. Already the commission's educational program explaining the technique and procedures involved in making term loans has had widespread acceptance among the smaller banks.

(2) Small business loans departments: Banks are setting up small business credit departments or are designating certain officers to give special attention and experienced service to the proprietors of small enterprises.

(3) Correspondent bank relationships: The banking system with more than \$100,000,000,000 on deposit provides a tremendous reservoir of potential credit. This will be released in most instances through the action of the individual banks in their local communities. In the event the local bank cannot make the loan itself for any reason, it calls upon its correspondent bank in a larger city to cooperate in making the credit or in giving expert advice and experienced counsel on the situation in an effort to make the loan bankable. The larger banks throughout the country are now holding meetings of their country correspondents to implement this program.

(4) Bank-credit groups: There will be cases where neither the local bank nor its city correspondent will be able to assume the full risk or be able to make the loan because of its size, character, or other circumstances. In order to meet such situations and provide a third source of credit within the banking structure itself, the commission is recommending the organization of voluntary credit groups in various sections of the country. This part of the program has met with outstanding success and already 31 such groups have been organized having credit reservoirs in excess of \$500,000,000. It is expected this total will soon reach approximately \$650,000,000 through the organization of new groups. These groups operate through banks and are of four different types, depending upon the territory served: (a)

Nation-wide; (b) regional, covering a trade area; (c) State-wide; and (d) local, for community use.

(5) Education and merchandising: A carefully prepared program of education is now under way. This is directed primarily to the bankers so that through the benefit of research, literature, and personal contact they may become familiar with new lending techniques and may extend the use of those now in operation. The entire economy will profit by this educational process.

Merchandising plays an important part in this phase of the program. The commission is urging every bank to merchandise vigorously its credits and services and providing banks with advertising material and sales guides which will assist them in enlarging the number and variety of their services to the people of their communities. The credit policy outlined in this memorandum and the program described here have been presented to more than 3,500 bankers representing all State bankers associations. Both the policy and the program received their enthusiastic endorsement and wholehearted support. State associations have set up committees and the work is being carried forward on a local basis.

The banks of the Nation through the postwar small business credit commission have made a solemn pledge to the American people that adequate credit will be made available to men of character and ability and that it will be provided by the American system of banking, a product of private enterprise and itself a creator of private enterprise. That pledge will be kept.

I am handing you with this statement, gentlemen, a progress report of the postwar small business credit commission, which has in the back a list of the bank credit groups which were formed up to March 1945. Since that time a good many more have been formed and have not yet been announced.

The CHAIRMAN. Mr. Folsom, on behalf of the staff, do you have some questions?

Mr. FOLSOM. There were one or two questions which we sent to you, Mr. Hanes: one was, under existing laws and regulatory procedures, what could be considered as preventing a bank from doing the job you think they can do?

Mr. HANES. You are speaking of regulatory authorities?

Mr. FOLSOM. Of existing law.

Mr. HANES. We have had very intimate discussions with the heads of the three regulatory bodies here in Washington—the Federal Reserve, the Comptroller of the Currency, and the FDIC, and we have met with a great many of the State banking supervisors, and tomorrow I am appearing before the State supervisors in convention here and will present this to them then.

We have definite assurance if a loan is made on a sound basis and amortized properly, the loan will not be criticized as slow or bad as long as the payments are kept up, even though they go as long as 10 years.

Mr. FOLSOM. I am speaking of any laws or regulations which would prevent the banks from doing the job you think they can do.

Mr. HANES. I do not believe there is any. We believe definitely that regulation should be had to prevent wildcat banking. We are dealing with other people's funds and our primary responsibility is to



look after them and give proper administration, and after that to serve our communities as best we can.

Mr. FOLSOM. The other question is, What is the attitude of the banks toward some type of guaranty of unusual risk which would make possible the use of credit not otherwise available?

Mr. HANES. We do not believe there is any reasonable risk the banks should not take; that is our business.

Mr. FOLSOM. You are familiar with the Wagner-Steagall bill.

Mr. HANES. Yes.

Mr. FOLSOM. Governor Draper of the Federal Reserve Board presented the Board's position on that; I would like to have your position.

Mr. HANES. We are opposed to the bill. We do not think it is necessary. We feel if they can determine to whom this \$139,000,000 they talk about belongs—I do not think that has been determined—if they determine it belongs to the Federal Reserve System, then we believe it should go into its capital structure to bolster it to take care of some of the increased liabilities that have been taken on by the Federal Reserve during the war and should not be used on a guaranty basis because we feel it is not needed.

Mr. FOLSOM. He indicated there might be loans of longer term than the banks ordinarily would want to make.

Mr. HANES. The banks are going pretty generally up to 10 years and that is as long as we feel the Federal Reserve should go. Beyond that it is equity money and should go into some form of equity.

The CHAIRMAN. Mr. Arthur.

Mr. ARTHUR. I wanted to ask one question somewhat along the same line. You mentioned the term of loans up to 10 years, but I am wondering about the possibility of securing credit in local communities for such enterprises as the purchase of war plants, where an equity operation is indicated, but probably considerable credit may be needed against fixed assets; is that the sort of thing these bank-credit groups would be able to accomplish?

Mr. HANES. Unquestionably, so long as the amount of money needed has proper relation to the amount of capital put up. If someone with half a million capital wanted \$5,000,000, obviously, it could not be done because that would be out of relation.

Mr. ARTHUR. Do you think there is an open channel for the flow of capital into that kind of enterprise outside of the banks?

Mr. HANES. I think unquestionably there is. In our section of the country I have never known of as much dammed up money seeking investment.

Mr. ARTHUR. The money is there, but how about the channel?

Mr. HANES. The main thing, in my opinion, that is keeping people from seeking investments is the lax laws. If a man makes a profit, he is going to get from 10 to 50 percent of it, but if he makes a loss, he has a 100-percent loss to take. There is no gamble there. When you buy equities, you are speculating, and when you take the risk you certainly should have an incentive to make a real profit.

On the other hand, you are having a 100-percent loss if it turns out bad.

Mr. ARTHUR. You do not see any lack of facilities such as the investment banking people provide for larger capital flotations for the fellow who is in the \$50,000 to \$500,000 enterprise?



Mr. HANES. I am not thoroughly conversant with the details of the investment bankers' proposal; I have not read it in detail, but it seems to me they are very sound in forming local groups for handling securities. In North Carolina we have five very good local dealers who have financed many small concerns from \$50,000 up, and they have had no difficulty where they have had merit and sound management. But I think we are confusing the needs of small business by saying money is the thing it needs most. Sound management is what it needs. If you do not have management, you do not have anything, and sooner or later the money will be lost if you do not have management.

The history of small business is that by far the larger percentage fails because management is not sound. That is the main thing small business needs and all business needs—intelligent, sound management.

Mr. ARTHUR. That is the reason for my question. As I see it, the investment banking group has the responsibility for finding the management and seeing that the funds and management are brought together.

Mr. HANES. Yes, and I believe they will do that. Often in the past individuals have invested just from enthusiasm over an idea, without looking at the management. A lot of securities have been sold, for example, because Mr. Ford made money out of automobiles and they thought they could do the same, but they did not have the brains Mr. Ford had and the concern went by the boards.

It seems to me the thing that is keeping equity capital from flowing into investment channels is, first, taxes, and second, the red tape and expense of the Securities and Exchange Commission, and I would like to confirm what Mr. Schram said. I also believe in the SEC, but the expense and the amount of time consumed in getting up these forms for small institutions make it entirely too expensive; they just cannot afford to do the thing. By the time they pay the lawyers, accountants, and everyone else, the cost is so great they cannot afford it, and it seems to me something should be done along that line.

Some bills are in Congress now to increase the limit so that the smaller corporations do not have to come under the Securities and Exchange Commission.

Mr. ZIMMERMAN. Will you pardon me at that point?

Mr. HANES. Yes, sir.

Mr. ZIMMERMAN. Is this requirement merely a regulation put into force by the Securities and Exchange Commission?

Mr. HANES. I think it is in the law.

Mr. ZIMMERMAN. In the law?

Mr. HANES. That is my understanding, that there has to be an act of Congress to change it.

Mr. ZIMMERMAN. That is one of the things you think Congress should give attention to?

Mr. HANES. Yes, sir; very serious consideration.

Mr. ZIMMERMAN. And I think that is one of the things this committee will recommend to Congress, and that, of course, is all we can do—make recommendation to Congress—and they may either approve or disapprove; but do you think that is—since it is a part of the basic law, it will require an act of Congress to make that change?

Mr. HANES. I think so, sir.

Mr. ZIMMERMAN. I did not know that was true.

Mr. HANES. It seems to me if the taxes and the Securities and Exchange Commission regulations could be changed, we would see a tremendous impetus in the buying of securities which, I think, would help the whole postwar problem of getting our people back to work and creating employment.

The CHAIRMAN. Have you finished, Mr. Arthur?

Mr. ARTHUR. Yes, sir.

The CHAIRMAN. Have you, Mr. Zimmerman?

Mr. ZIMMERMAN. Yes.

The CHAIRMAN. If I may, Mr. Hanes—if I get the purport of your statement, sir, you do not think there is any affirmative action necessary by Congress to assist in the financing of the so-called small business; that category you have set out there as the small business?

Mr. HANES. Well, I think definitely there are enough agencies set up. You have the RFC, which can do anything these other agencies can do. There is the Federal Housing Administration for mortgage loans, and there are the various farm agencies for agricultural loans. So I do not think it is necessary to set up additional machinery because it is all here now and ready to be used.

The CHAIRMAN. But aside from that, if I get the purport of your statement, the banks have sufficient money on hand with which to finance these people?

Mr. HANES. Yes, sir; ample.

The CHAIRMAN. We are urged every day repeatedly to help the small businessman in the postwar period, to assist the returning veteran to get into business.

Mr. HANES. Yes, sir.

The CHAIRMAN. Your thought is, if I understand correctly, that that is not necessary on the part of the Congress; that any business that would be undertaken of that nature could be amply financed by private institutions if it were a business susceptible of succeeding?

Mr. HANES. Yes, sir. I wonder if I might give two or three illustrations of that, sir?

A man came to us the other day who has been in the retail electrical supply business, selling retail electric merchandise. He wanted to go into the wholesale business. One of his boys is coming home from the service and he has another boy who is now working for a corporation but who is going to quit his job and return to work with his father.

Now, this man had a small net worth; it was only about \$5,000 in his business. He wanted to borrow about \$15,000. He had \$5,000 in his business and he owned his home free and clear; he had all together about \$15,000 and he wanted to borrow \$15,000 to go into the wholesale business. Of course, he cannot get his equipment and supplies now; he cannot get electric sweepers, refrigerators, and various things he wanted to sell, but before he could go to the manufacturers and make contracts, he had to be assured he would be financed.

As I say, he wanted \$15,000 for 5 years, and we went into the matter with him. His record was good. He had shown by the conduct of his retail business that he had sufficient capacity; that he was a man of character and had paid his debts.

We gave him a commitment that whenever he can get the goods to go into the wholesale business we will lend him \$15,000. He has

made his contacts with the manufacturers and as soon as the goods are available he is ready to go into the wholesale business.

We have been asked why these credit groups have not loaned money so far. Here is one instance why they have not: We have made a commitment but cannot make the loan before the goods are available, and that is true throughout industry today.

Civilian goods are not available, but the credits have to be arranged so that we can move into peacetime economy and start people in that work.

The CHAIRMAN. Mr. HANES, I am just a little concerned about the experience in the era preceding the war. The small banks took the position they could not make these long-time loans. I have not had an opportunity to read your report here, but is there some machinery that you propose to set up here that will, through some cooperative or underwriting basis, permit those long-time loans?

Mr. HANES. This term lending business is rather a new technique in banking. For a long while 60 days, 90 days, 4 months, or 6 months was as far as we thought we could go because we thought we could not take risks over a long period of time. The whole difficulty in the mortgage field and in business was that we were making loans without amortization.

The history has been where loans are properly amortized there is very little loss. In the so-called short loan, although it may have been supposed to run for 60 or 90 days, it actually in many instances ran for as much as 10 years without curtailment, and then often the business would get so bad the loan could not be collected.

Now had those loans been amortized, by the time the borrower had to go out of business the bank would have received sufficient so that it would not have suffered much loss, whereas by carrying the whole loan for 10 years the bank lost the whole amount, or a good part of it.

While it has been done in the mortgage lending field for a great many years, it is only in the last 5 years that banks have made loans in volume over a period of years. They first extended them to 1 year and then to 2 years and then to 5 years, and now they are lending quite freely for periods as long as 10 years.

The CHAIRMAN. There is nothing in the FDIC that would interfere with that procedure?

Mr. HANES. The banks have been criticized in the past for having slow loans running without curtailment, and this is an additional reason why we should have monthly or quarterly or semiannual or annual reductions. Mr. Crowley, in his last report, said that banks had to take longer risks and that this old fetish of 60- or 90-day credits had more or less passed out.

The CHAIRMAN. That brings up something I would like to get around to. We all recall that in the depression era when a good many of the banks were closed as a result of the bank holiday, when they reopened it was a pretty hard thing to get a loan for any business, however meritorious it might be; the banks, just fresh from that experience, were very timid; they just were scared, in plain words.

Now, is there any danger of that situation existing in the postwar period?

Mr. HANES. I do not know whether you have ever done any quail shooting or not, but if you have, you know if you shoot your dog he leaves and is gun-shy for some time.



The CHAIRMAN. That is the point.

Mr. HANES. The losses incurred over the years have been large. One reason, as I said, is that management in business has not always been the best. But in the past loans were made supposedly to be repaid in 60 or 90 days or 3 or 4 months, and they have been carried on with no reduction for years and years, and that has been the main difficulty.

The next thing we advocate is that banks set up proper reserves as they go along; out of your interest earnings each year you set up what you think your losses may be over the period of years.

In our institution we took a survey from 1928 to 1938. That took us through good years and bad. We found our losses had been one-half of 1 percent. So we are setting up one-half percent of our loans, knowing that if we do a good banking job we will lose that much money. We are self-insurers on our loans, and that is why we do not need Government insurance.

Had banks done that, they could have taken their losses in their stride over the depression years and gone right on lending just the same through the depression years and would never have been shocked by losses because they had already provided for them.

The CHAIRMAN. And yet the enactment of FDIC did give confidence that has resulted in much better conditions.

Mr. HANES. There is no question but that is true.

Mr. ZIMMERMAN. That is very interesting. That half of 1 percent you set aside as a reserve to take care of future losses is in addition to the amount you set aside for surplus and undivided profits?

Mr. HANES. Yes, sir.

Mr. ZIMMERMAN. That is something that is put aside and not carried as part of the assets of the bank?

Mr. HANES. The whole idea is that these reserves will take care of losses without touching the capital structure, surplus, undivided profits, or capital.

Mr. ZIMMERMAN. That is an interesting thought.

Mr. HANES. Yes.

The CHAIRMAN. Mr. Hanes, I would like to say for the benefit of the record and for your information, sir, that if there is one thing above everything else this committee has stressed, it has been the continuation of the American institution of private enterprise. We do not want to see anything done that would interfere with that, and yet, for the reasons I mentioned a moment ago, there is considerable apprehension that private banking will not meet the situation that will exist.

I certainly hope, sir, that your views, which might seem a little optimistic to some, are well-founded, and I am not challenging them.

Mr. HANES. Of course, only the future will tell. As I have said, we made a Nation-wide trip from coast to coast and from north to south and talked to 3,500 bankers and in turn they talked to 2,200 banking groups. We have gone through the State associations and have told the bankers we have the problem in our lap to finance postwar industry soundly.

That does not mean every bank in the United States will carry on the program, because we have good, bad, and indifferent bankers just as you have good, bad, and indifferent Congressmen.

The CHAIRMAN. I think that is a fair statement.



Mr. HANES. The reason our private economy will exist is the same as the reason that Congress exists, and that is because the great majority of men are good, but we shall have bankers who will not have any part of this program; they will just get into their bombproof shelters and buy bonds.

But we hope that bankers in all communities will go out and take all intelligent risks and extend their activities into those communities where the local bankers refuse to take them. We are telling the public they are going to do it. I have had a few letters from Alabama to the south and as far as Montana to the west complaining of the failure of banks to make loans. We have referred them to our committeemen in these sections and they have taken the loan back to the local bank, and in the great majority of cases there was a real reason why the loan could not be made. On the other hand, we have had one instance where the local bank did not make the loan but a bank within the area did make it.

The CHAIRMAN. Mr. LeFevre.

Mr. LEFEVRE. Mr. Hanes, I want to compliment you on the report. It shows the bankers are on the job, and I am glad to see the bank examiners have come to look favorably on the long-term loan.

Mr. HANES. That is right, sir.

Mr. LEFEVRE. I have seen them criticize many loans for being slow.

Mr. HANES. I am appearing before the State supervisors tomorrow and have already seen the supervisory authorities here in Washington, and we are assured that as long as the loan is made soundly to a person of character and capacity, even though his balance sheet may be thin, if the record shows he is capable of management and proper amortization is set up, they will not criticize the loan.

Mr. LEFEVRE. Thank you.

Mr. ZIMMERMAN. I am glad to hear that. Coming from a small country town, I have had some connection with bankers in our section, and I know for a fact, after the establishment of the FDIC they made it pretty hard on country banks. In other words, it has been pretty difficult to even furnish money to a cotton farmer where he had plenty of mules and farm machinery and his integrity was good and he had good land to make a cotton crop that we know brings about so much money.

We had a lot of trouble getting them to approve those loans, and I am glad you boys have worked out a credit for a longer term.

(Discussion off the record.)

Mr. ZIMMERMAN. Do you not think the case of the man you mentioned who has his two sons coming back into business with him, is typical of the situation all over the country where filling stations have closed down during the war—there are half a dozen of them in my little town—and there are a lot of things that had to close down because of the necessity of war activity. They are going to come back into business, and there is where I think the country banker will have a chance to lend that money he has held so long, and I think we will see a great expansion in business. I think that is going to solve our problem.

Mr. HANES. We are stressing in this whole program that bankers should pin their faith to the competent man, that character and ca-

capacity go a long way and when you find such a man you can bet on him and go along with him.

In addition to the tremendous increase in bank deposits, from \$45 billion in 1940 to over \$100 billion at present, the circulation has also tremendously increased, and there is money in old socks and safety-deposit boxes and in other places. There is a tremendous amount of money that should be brought back into use.

Of course, a large circulation is needed because of increased business volume but I do not think this tremendous increase of 500 percent in the last 10 years has been entirely needed for that; I think a lot of it has gone into hoarding.

Mr. FOLSOM. The Reconstruction Finance Corporation has a plan to advance three-fourths on loans made by individual banks; will the banks make any use of that?

Mr. HANES. That is so new I have not been able to look into it. I hope to discuss that today and see what they intend doing with the program. I have had a letter on it from the manager of our North Carolina agency, but I am not well enough informed to discuss it.

Mr. FOLSOM. From what you say there would be no need of money from the RFC.

Mr. HANES. I think that is quite true, that we do not need it, but I would like to see what their plan is definitely before I would want to comment on it.

The CHAIRMAN. Anything further, Mr. Folsom?

Mr. FOLSOM. No, sir.

The CHAIRMAN. Mr. Hanes, we are very grateful for your attendance and your splendid statement. It is very refreshing and optimistic in its nature, and I am sure it is based upon a great deal of study on your part. We are very grateful to you.

Mr. HANES. May I thank all of you gentlemen for your kindness in hearing me.

The CHAIRMAN. Thank you very much. The committee will stand adjourned.

(Whereupon, at 12:05 p. m., the committee adjourned.)

# POSTWAR ECONOMIC POLICY AND PLANNING

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THURSDAY, MAY 31, 1945

HOUSE OF REPRESENTATIVES,  
SPECIAL COMMITTEE ON POSTWAR  
ECONOMIC POLICY AND PLANNING,  
*Washington, D. C.*

The special committee met, pursuant to notice, at 10:30 a. m., in room 1401, New House Office Building, Hon. William M. Colmer (chairman) presiding.

Present: Representatives Colmer (chairman), Zimmerman, Murdock, Fogarty, Walter, and Wolverton.

Also present: M. B. Folsom, staff director; and Ernest J. Hopkins, consultant, of the special committee.

The CHAIRMAN. The committee will come to order.

For the benefit of the record, we are grateful to Mr. F. Eberstadt for his appearance here this morning.

## • STATEMENT OF F. EBERSTADT

The CHAIRMAN. Mr. Eberstadt, for the record, will you state your business, please, sir?

Mr. EBERSTADT. My name is Ferdinand Eberstadt. I am a partner in the firm of F. Eberstadt & Co., 39 Broadway, New York City, investment bankers.

The CHAIRMAN. Mr. Eberstadt, I believe you have a prepared statement. However, you may utilize the time as you see fit; read your statement, and if there are questions you may answer them or request that questions be withheld until you finish with your statement.

Mr. EBERSTADT. Mr. Chairman, with your permission, I will skim over this statement and if there are any questions, I will be glad to try to respond to them.

The CHAIRMAN. Very well, sir.

Mr. EBERSTADT. I would appreciate having the record show that I am not appearing before this committee on behalf of, or as the representative of, any group or organization. I am here simply as an individual and at the committee's invitation. No one but myself is responsible for what I say.

The reports of this committee indicate clearly its realization of the importance and desirability of a free and active private investment market as a stimulant to business and employment in the postwar period. This view seems to be quite generally shared by informed people in business, labor, and Government circles. Less general, however, is the realization that certain provisions of our securities laws and regulations and certain administrative practices and procedures of

the SEC thereunder may constitute such serious obstacles to the free flow of capital as to jeopardize our attaining the volume of private investment necessary to support that measure of production, consumption, and employment which all of us hope for.

Sustained high levels of business and employment in the postwar period will, of course, require a favorable concurrence of many elements. No single one, however favorable, can alone produce this result. And so, I don't want to seem to overestimate the relation of active private capital markets to postwar business. But no one, I think will dispute the statement that they constitute one very essential link in the chain of good business.

If we are to have peacetime production, consumption, and employment levels beyond anything that we have yet achieved in this country, we will also need a volume of private investment beyond anything heretofore reached. Otherwise Government will have to furnish the necessary funds at the cost of the taxpayers.

In addition to its stimulating contribution to postwar business and employment, an active private investment market can make a further very substantial contribution to our national economy through furnishing from private sources, a large amount of the funds necessary to purchase surplus Government-owned war plants and equipment, with resulting reduction of our governmental deficit to the considerable benefit of the taxpayers.

How high the total volume of postwar investment will be is a matter of opinion. The differences amongst authorities is considerable. A recent release of the Securities and Exchange Commission seems to indicate that, in their opinion, business will not need substantial additional funds. A more recent report of the Twentieth Century Fund indicates that requirements may run as high as \$28,000,000,000 per annum. In 1929 the total of corporate flotations amounted to over \$10,000,000,000 and the average for 10 years preceding amounted to over \$5,000,000,000 per annum. The largest amount of corporate flotations since 1933, when the SEC was established, was \$4,600,000,000 in 1936. Not all of this, of course, needed to be registered with the SEC. The average amount of flotations for the years 1934 to 1944, inclusive, was \$2,200,000,000. There is more than a mere coincidence between volume of investment and degree of employment.

Adopting the relationship between flotations in 1929 and the gross national product that year, if we are to have a gross national product of \$160,000,000,000 in the postwar years, we can expect flotations of around \$16,000,000,000 per annum. A large part of such flotations will require registration under the Securities Act of 1933. The largest amount of new issues registered with the SEC was slightly under 4 billions in the year 1936. If the issues to be registered with the SEC during the postwar years amount to 16 billions per annum, they will approximately equal the total amount of the registrations with the SEC during the 10 years from 1935 to 1944, inclusive. I question the ability of the present mechanism to carry this burden.

There will unquestionably be a strong demand for investment funds to reduce costs through refunding, to convert plants from war to peacetime uses, to increase efficiency through new plants, equipment, and installations; to start new businesses and to expand present ones—to say nothing of the demand for funds from abroad, the importance



and probable magnitude of which has been referred to in your reports. There is already considerable evidence of a strong and growing demand for such funds on the part of business, large and small. Its outstanding performance during the war has restored the confidence of American business, which was badly shaken during the depression and the years that followed. Businessmen are now more eager than ever to go ahead, armed not only with greater technical knowledge but also with a fuller realization that enlightened social and labor policies are good business. Industrialists generally realize that if we are to have sustained good business, they must pay good wages, must constantly reduce their costs, and must sell a constantly improved product at decreasing prices to the consumer. This progress requires the efficient use of large amounts of capital—an art in which Americans excel.

I would like to digress for a moment, with the committee's permission, to give you some interesting figures.

The CHAIRMAN. All right, sir.

Mr. EBERSTADT. I want to amplify with some figures the statement which I made as to the importance of the relation of capital to the productivity of the worker.

According to these figures, which I quote from a leaflet by Shop Management Planning, Inc., of Jersey City, N. J., dated February 1945, reprinted from the magazine *Chemical Industry*, in 1879 there was in this country 1.3 horsepower per worker, roughly; the average output of the worker amounted to \$1,960 per annum; his average wage amounted to \$346 per annum. In 1939, there were 6.4 horsepower per worker in this country; the annual output per worker had a value of \$7,200, and the annual wage amounted to \$1,150.

Now, I will return to my statement.

On the other hand, there is no doubt of the existence of tremendous funds in private hands eager for productive private investment. In the 25 years that I have been connected with this business, I have never seen anything like it, not even in 1929.

However, in spite of the tremendous amount of capital which is available and the great need and desire of business to obtain and use it, the union of these two will not come about in the desired measure if there remain serious obstacles to the transfer of this private capital to business enterprises.

Under the laws now on our statute books, the major portion of private investment is subject to the provisions of the Securities Act of 1933, as amended. This is one of four principal statutes administered by the Securities and Exchange Commission, the other three being the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940. All of these acts affect private investment. The oldest has been on the books for 12 years, the shortest for about 5 years. Thus considerable experience in their operation has been obtained by the SEC, by the investment banking fraternity and by business. The results of experience over these years are available to your committee.

The importance of active private investment markets in relation to postwar business and employment, is such as, in my opinion, to justify a thorough examination by your committee of these statutes and the practices, rules and regulations adopted by the SEC pur-

suant thereto with a view to keeping that portion which is sound and constructive and to eliminating that portion which is unnecessarily obstructive, cumbersome, dilatory, and expensive.

I would like to make it very clear that I am not suggesting the repeal of all or any of these acts. In my opinion if the investment banking fraternity were faced with the alternative of the acts as they are or repeal in toto, I believe that they would prefer the former. But those are not the only alternatives. The constructive course, it seems to me, is to review these acts and their administration in the light of experience, looking not to their elimination but to their improvement.

Nor do I suggest that the penalties for malfeasance be lightened. On the contrary, I see no objection to maintaining or even increasing their severity where fraud or other malfeasance is clearly present. I do, however, question the wisdom of handicapping our postwar recovery by retaining unnecessary burdens of time, work and expense upon the great majority of business people, large and small, who approach the private investment capital market with no sinister purpose but solely in response to their understandable ambition to start or to expand legitimate enterprises for the benefit of themselves, their families, their workers, and their customers.

You have invited attention to the importance of foreign loans. This is a long story but I hazard the guess that no substantial amount of private foreign loans is likely to pass through the fine mesh of the filter of present laws and regulations. Our own people may have to continue to follow the present complicated and intricate procedures in order to get private capital, but the foreign borrower will prefer the simpler procedures of the London market.

Our firm was one of the very first to accept this legislation in good grace and to act under it. During the 12 years since 1933, we have handled issues under these acts running into many millions for a wide variety of companies, mostly of moderate size. Our relations with the members of the Commission and its staff have been excellent. At no time have we had cause to complain about their attitude nor, I am happy to be able to state, have they ever directed a complaint of any sort at us. I say that in order to remove any suspicion that we have even the slightest grievance toward the Commission. Exactly the contrary is true. Far from bearing resentment, we are grateful for many helpful accommodations which they have extended to us. I am not criticizing the attitude of the umpire. I am suggesting that the rules of the game as they now exist and are administered offer a threat to obtaining the volume of business and employment which, next to military victory, seems to be the thing that our people most ardently desire.

I fear that it will not be possible to clear the tremendous volume of private investment which will be necessary to support the volume of employment which we want, through the statutes and administrative procedures which now exist. It is for that reason, that I have taken the liberty of suggesting to this committee that you examine thoroughly not only the four acts themselves, but the rules, regulations, procedures, and forms through which these acts are being administered.

No one questions the importance of full disclosure of material facts and adequate protection to the investor. But I doubt that there is any

general desire to carry this laudable objective to such a quixotic point that in attempting to protect the investor from any possible loss of money, we unintentionally hinder the raising of capital to the point of preventing thousands from finding productive employment.

I think that the results of such an investigation will disclose, at least so far as the Securities Act of 1933 is concerned, that the statutes are unduly restrictive, involved, and unclear, that procedures thereunder are unnecessarily expensive, dilatory, and redundant, and that without sacrificing in any respect—I might say even strengthening—the basic purpose of these acts, their language and administration can be greatly simplified.

I do not now wish to take the time of the committee by going into the multitude of detail and technical questions involved in such an examination, but I would like to point out that in our experience it has not been possible to register a new issue without expenses running into many thousands of dollars. In our own issues, costs to the companies have usually run between \$20,000 and \$50,000 per issue. These are not large but moderate-sized issues. They may run from a million or 5 to 6 million. Simplification of the registration procedures would not, of course, eliminate all expenses but it could reduce them substantially. It has not proven possible to complete an issue of securities in less than 60 to 90 days. It requires the full time of a staff of lawyers, accountants, and usually some other experts. Frequently there are many trips to Philadelphia. That is no particular inconvenience for bankers located in New York City, but it must constitute a considerable burden to companies located in the Midwest, South, on the west coast, or in the Southwest.

It has always seemed to me painting the lily a bit that a company whose securities have been listed and traded on a national stock exchange for many years and about which the fullest information is readily available, should be required to duplicate all of this information in the form of an elaborate registration statement and prospectus if it desires to make a public offering of new securities.

A particularly striking situation exists where such a company wants to increase the amount of an issue already outstanding, listed and traded in daily. Under these circumstances that portion of the issue which is listed can be bought and sold with no particular formalities, while dealings in the new issue, with identically the same rights and provisions, must be supported by a registration statement and prospectus. It is difficult to see why one class of purchaser needs so much more protection than the other.

I have wondered why it should be necessary for a company which has once registered, to duplicate practically the entire registration on a subsequent registration. The printing costs alone of these documents runs into many thousands of dollars.

As you know, in addition to the Federal SEC, many States have their own separate State SEC's. In order to be eligible for interstate sale, most substantial issues must also be presented for scrutiny by the so-called Blue Sky Commissions of the States where the securities are to be sold.

This means more time, more expense, more work. Here again, I do not want to criticize the State authorities. We have found them competent and reasonable. That's not the point. The point is that here is just one more obstacle.



I have wondered why, instead of concurrent jurisdiction, the SEC and the blue-sky authorities should not divide the field, the State commissions retaining jurisdiction on issues, say, up to \$1,000,000 and accepting the Federal SEC on issues above that.

The registration statement and prospectus in their present form are so complicated that certainly the average man cannot understand them, and even professionals in the business have considerable difficulty in extracting the salient information. They are, I think, read by few and understood by less.

To big business, all this red tape is chiefly a nuisance and expense. They have or can hire lawyers, accountants, and experts of all sorts. They don't enjoy it, but they can take it if they have to. Furthermore, they are frequently able to circumvent the burdens of registration by private placement. But to smaller and particularly to new companies, these burdens constitute a serious obstacle to obtaining capital. Similarly, the large Wall Street investment banker can get along after a fashion, but the small local underwriter simply can't make the grade. Local investment capital markets have practically disappeared. The consequences of this to small business may be quite serious. When a local investment house gets a financing deal, it is practically compelled to bring it to Wall Street, because the local dealer, generally speaking, has neither the technical knowledge nor the expert assistance required to accomplish the major feat of registration.

I have taken the liberty of delivering to you copies of what I think to be average registration statements and prospectuses.

Here they are, gentlemen. That one relates to the Hewitt Rubber Co., just completed. [Distributes document.]

This is the Braniff Airways of just a short time ago; and here is a third, the Armstrong Rubber Co., just completed. [Distributes documents.]

I am not giving you the host of exhibits which usually accompany the filing of these documents. In support of my statements, I ask that you undertake the task of reading these documents, realizing that they are required in the case of every substantial issue, and then conclude on your own part whether or not they are a stimulant to private investment markets. In contrast, I also deliver to you a few copies of British prospectuses.

There is one British prospectus; there is another. [Distributes documents.]

Mr. WALTER. Are the companies comparable in size?

Mr. EBERSTADT. I imagine the British are somewhat larger, but the prospectuses show the amounts in each case.

One set of documents is four or five pages, and the other is several hundred pages.

Mr. MURDOCK. These American, are they duplicates? Do they contain duplicates?

Mr. EBERSTADT. No; there are no duplicates. This is one separate, relating to one issue, the Braniff Airways. It is, in a very great measure, a duplicate of a similar registration filed a couple of years before, but there is no duplication in these papers.

Mr. MURDOCK. I see.

Mr. EBERSTADT. I think the contrast is quite marked.



If, after such study, you are still not convinced, I would like to direct your attention to the mass of SEC regulations, bulletins, forms, and releases, none of which is distinguished for brevity, clarity, or simplicity, and all of which to a greater or less degree affect private investment. In aggregate they constitute a formidable monument equaled, so far as I know, only by the rules, regulations, and forms of our income tax.

As the statutes now exist, I believe that Congress has conferred upon the SEC tremendous power over American business. The power to influence the flow of private investment is the power not only to influence the level of business and employment but to affect the very nature of our economic system. For the most part I believe that the Commission has used this power moderately and constructively, but I feel that any laws of this magnitude which at the time of their enactment constituted a major departure in our business and economic policy should be reviewed by Congress in the light of experience.

The suggestion that I make is not a new one. Efforts have been made over the past years to improve the situation. Bills have been introduced into Congress. Some effecting minor ameliorations have, in fact, been passed. The SEC and representatives of the investment-banking fraternity have spent long days and weeks in conference in a not very successful effort to agree on the desirability of certain amendments of rather limited importance.

I had intended to leave with the committee, but I think you have already received it, a copy of the report of those conferences. So far as I know, nothing further than the preparation of a report eventually evolved.

I see no hope of progress along these lines. Never, so far as I know, since this legislation was passed, has the whole field been looked over carefully, scrutinizingly, and constructively by a congressional committee. It seems to me that this is a particularly significant time to undertake this task and that your committee has an unusual opportunity to do a very constructive job.

I would not wish to give the impression that such a review would be either easy or simple. On the contrary, it would be a difficult and involved investigation. But I think the results would fully justify the time and effort so spent.

Before closing I would like to repeat that I don't want to give the impression that an active private investment market is the only or even the most important stimulant to postwar business. The effect of the income-tax laws, particularly in the case of small and new ventures, is very important. I simply want to point out that the securities acts themselves, and equally the method of their administration, are factors of major importance to our postwar business and employment picture.

If, as a result of such examination, your committee is able to recommend changes which, while not reducing protection to the investor, will result in stimulating the flow of private-investment capital, I believe you will have performed a signal service alike to business and labor, for which both will be duly appreciative.

The CHAIRMAN. Mr. Eberstadt, on behalf of the committee I want to thank you for a very clear, simple statement. I mean by that, the simplicity of your language is very admirable.

On the other hand, I must confess my lack of knowledge of the subject. I get this reaction to your statement—that you think that the red tape—for the want of a better word—and the requirements of the Commission are very burdensome. You, for instance, exhibit prospectus statements that are required by the Commission and then contrast that with one that is required by the similar British authority.

Of course, we have not had an opportunity yet to weigh and investigate those statements or prospectuses; but, being perfectly frank about it, I don't get—my lay mind doesn't get any definite recommendation other than it ought to be simplified.

I am just wondering how you would simplify it.

I don't know who, on the committee, is competent to answer that question unless it is the distinguished gentleman from New Jersey, Mr. Wolverton, who, I believe, is a member of the Interstate and Foreign Commerce Committee of the House.

MR. WOLVERTON. That is right.

THE CHAIRMAN. I will yield to him, because I see that he wants to make an observation.

MR. WOLVERTON. Mr. Chairman, I wanted to supplement the reaction that you had to the reading of this statement.

Continually, throughout the reading of the statement, I made checks with respect to the criticisms that were directed; but in no instance was there any specific suggestion made, so that where these criticisms have been made in this statement, I, for my own information, was prepared to take each one of them and ask: What would you do about it? What is your suggestion?

Now, if I may make a personal reference to my connection with this legislation, I would like to say that I was a member of the Interstate and Foreign Commerce Committee when all of these statutes were passed, the Stock Exchange Act, Holding Company Act, the Investment Act, the creation of the Securities and Exchange Commission, and I was on the subcommittee that prepared that legislation. I don't wish to infer that I agreed with everything that was in it.

Our present Speaker was the chairman of that committee, and he was also chairman of the subcommittee that drew this legislation.

Now, my general reaction to this is as follows:

I am confident that there is much that needs change, so far as the administration of the acts is concerned; but I am inclined to think, Mr. Eberstadt, that the criticisms which you make are all of matters that could be changed by regulation of the Securities and Exchange Commission and do not necessitate changes in the basic law. The basic law had but one theory, namely, to prevent fraud. The operation of the act was left to the Securities and Exchange Commission, and much that has come to the attention of our committee, over a period of years, has been objection to the manner in which the act is administered. Too frequently we have had presented to our committee statutes to change what could be changed by the Commission itself, in the administration of the act.

The point that I am endeavoring to make is this—that, until Mr. Eberstadt is specific as to what remedy is necessary and in what particulars it should apply, this committee would not be in a position to ascertain just how far it requires legislation and how far it merely requires a change in administration.

Now, may I say this—and do it without any rancor; it only reflects what I have said on many occasions in our own committee—I am fearful that the failure of the SEC to fully appreciate the effect of some of the things that they do, by way of rules and regulations, is due to the fact that in all instances, on that Commission, the individuals who make the rules and regulations have not had that practical experience that, in my judgment, enables them to fully appreciate the effect of what they are doing, from a practical business standpoint.

I have no complaint to make that everything they do is not in an effort to prevent fraud and deceit and deception and protect the investor, but I am fearful that they lose sight, sometimes, of the practical side of it, and due to the fact that they have not had the practical experience that is necessary before becoming a member of the Commission.

The CHAIRMAN. Yes. Of course, Mr. Wolverton, that is a matter of administration, not anything which we could do something about.

Mr. EBERSTADT. May I comment, Mr. Wolverton—

The CHAIRMAN. Pardon; I hate to leave any statement suspended there, because I was sincere in what I said about the fullness and frankness and yet simplicity of your statement in the argument for the suggestion for some simplification of this procedure.

I will be frank with you. I am awed by the exhibit that you have made here, which is, roughly, for the sake of the record, about the size of a Sears, Roebuck catalog.

Mr. WALTER. Even as voluminous as it is, there have been instances, I know personally, where sufficient information was not provided, and people have been imposed upon.

Now, this Commission, instead of being an autocratic agency such as the impression was created that it is, has endeavored not only to carry out the purposes of the act but to aid business.

Now, the fact that the report is large does not mean a thing. Perhaps the British reports are faulty, but I certainly think that the SEC endeavors to the best of its ability to avoid compelling business people to do things that they find obnoxious or objectionable.

The CHAIRMAN. Well, I come back to the point that I started with, and then I am going to leave it there—that this committee is intensely interested, Mr. Eberstadt, in getting the objective which you are arguing for here, of the proper economic condition of the country in the postwar period, and we want to do everything we can to stimulate private industry, stimulate the flow of private capital and investment capital. I think we are all agreed on that, but I think that we should have something specific.

I am sorry, Mr. Eberstadt, but we will have to recess now. However, we will be back here at 12 o'clock, if that is convenient.

Mr. EBERSTADT. I am at the disposal of the committee now, or any other time.

(Whereupon, at 11:30 a. m., a recess was taken until 12 noon of the same day.)

#### AFTERNOON SESSION

(The committee reconvened at 12 noon, at the conclusion of the recess.)

The CHAIRMAN. Mr. Eberstadt, when it was necessary for us to take the recess to go to the floor, some question had been raised about your



statement not having been specific enough, although we were rather commendatory of the purpose you sought.

So, I think, in fairness to you at this time, you should be given an opportunity to answer those allegations as to the lack of being specific.

Mr. EBERSTADT. Well, Mr. Chairman, I didn't realize that I was being invited down here to make specific suggestions, or I would have been prepared to make them. I don't want to take advantage of any remarks that have been made here, but if I could interpret any of these remarks as an invitation to make specific suggestions, I would welcome that, and I will be happy indeed to do so.

The CHAIRMAN. I assure you that is what the committee would like to have, sir.

Mr. EBERSTADT. They will be forthcoming, sir. (See exhibit 3, p. 2508.)

If I might comment on some of the remarks made, Mr. Wolverton contrasted the changes that might be desirable in the regulations, with what he regarded as the rather limited number of changes required in the acts.

Your committee has in its file here a report of 285 pages, giving about 100 changes in the acts which were discussed by the industry and the SEC.

Of those changes suggested——

The CHAIRMAN. You mean changes that would be desirable?

Mr. EBERSTADT. Where changes would be desirable in the acts themselves—having nothing to do with the regulations.

Mr. WOLVERTON. May I say there, Mr. Chairman, that my statement was directed to legislation that had appeared before our committee; that the legislation which had appeared before our committee was of a character that the relief sought could have been granted by changes in rules and regulations in most instances. These subjects that are referred to in this report, by the witness, have not been presented to the Committee on Interstate and Foreign Commerce in the form of proposed legislation.

Mr. EBERSTADT. It is evident that I misunderstood Mr. Wolverton. I got the impression, from his remarks, that he thought the matters which I brought before the committee's attention here today could be remedied by changes in the rules and regulations and would not require legislation.

I think you would agree with me, after reading this report here [indicating] that certain major changes in the acts are necessary. Their necessity to a considerable extent has been recognized by the SEC.

Mr. WOLVERTON. The report to which you refer, so far as I know, has never been presented to the Committee on Interstate and Foreign Commerce.

Mr. EBERSTADT. I don't know—I understand it has been presented. At any rate, I think no action has been taken on it, Mr. Wolverton.

Mr. WOLVERTON. I assume that what has been done is, a copy has been sent to the chairman. Was there, accompanying the report, any request for legislation along the lines that are mentioned in the report?

Mr. PETER T. BANE (of the Securities and Exchange Commission). There wasn't any specific bill, except the bill by Mr. Wadsworth—that was in the form of a bill. Then, the other was not in the form



of a bill but was in the form of hearings on suggestions made, and there was a report like that by the industry and one similar to that by the Commission itself.

Mr. EBERSTADT. As I say, I will be very glad to prepare specific suggestions, but such a thing as this would be the type of suggestion I would have in mind—and I mentioned it in my statement—where you have a stock that has been listed on a national exchange for years, and the company desires to issue additional stock of that same category, a customer can buy all the stock he wants and sell all he wants, across the board, with no trouble at all, yet if he wants to buy part of the new issue, which is the identical stock, it is necessary to take the time and expense of preparing a registration statement.

Well, it is difficult for me to see why, as I pointed out, it is necessary to do that in a sale by one group of salesmen, and not by another group of salesmen.

Mr. WALTER. May I interrupt at that point?

I know of instances where companies have changed their financial structure without adding any additional stock. Why, in those cases, shouldn't it be sufficient that the officers of the company merely file an affidavit in which they state that underlying the new issue is the same security that is underlying the other issue, or something of the sort?

Mr. EBERSTADT. Mr. Walter, I don't know all the details of the case. These things are rather technical. I would be glad to give you an answer, but I don't—

Mr. WALTER. I have in mind a company in which there would be four or five different issues of stock, and the company would decide to call all that stock in and issue new stock, the basis of which would be exactly the same security that was back of the other issue. Certainly the directors of that company, if an affidavit would suffice, would not swear falsely, and that would obviate the necessity of preparing quite voluminous prospectuses.

Mr. EBERSTADT. I might point out—that doesn't involve the obtaining of any new capital, does it?

Mr. WALTER. No.

Mr. EBERSTADT. I think that is where there is simply a readjustment of capital structure, with no underwriting and no new capital, the registration statement in those cases is not required, but we have an expert on that here—I think I am correct.

Mr. BANE. Yes.

Mr. EBERSTADT. I know of no instance where a company seeking new capital does not have to register.

Mr. Walter, while we were talking, you mentioned the length of the prospectus. It seems to me the fullness of disclosure is not dependent on the length of the prospectus. You can make it two or three or even five times as long and still not disclose certain relevant facts.

There are certain very relevant facts which relate to investment that are not disclosed, even pursuant to the present rules and regulations.

One example is management. It seems to me that the primary essential of every investment is the nature, character, ability, and experience of the management. There is, so far as I know, no requirement on that. So I would like to point out that it would be

possible to decrease the size of those documents materially and still have even more complete disclosure.

What has happened, I think, is this: The acts were passed as the result of a situation with which we are all familiar, against a background of no actual experience in this type of legislation or regulation. The two slogans on the banner were "Let the seller beware" and the other, "Truth in securities," and those are two very worthy slogans; but in the administration of the act, I think certain rather normal things have occurred. One is, the administrative groups have reached out to extend their authority; the other is that the exercise of that authority has become highly centralized; the third is that the administration has assumed an extremely detailed aspect; the fourth is that I think the Commission has taken the mandate not simply to see that there would be truth in securities and let the seller beware, but to exercise a general moral supervision over all business procedure in the financial field. And I rather think that goes beyond the objectives of the act.

The CHAIRMAN. I wonder if you will permit an interruption there? You seem to have finished on that point.

Mr. EBERSTADT. Yes.

The CHAIRMAN. Mr. Murdock has a question that he desires to ask.

Mr. MURDOCK. It is just a little more than a question, Mr. Chairman.

I want to supplement what the chairman said about your statement. It is clear and forceful and I have followed you with great interest and I am going to take this with me [indicating statement] and read it with equally great interest again.

I am glad the chairman of the subcommittee of this committee that deals with mines and mining is present. I want to say, coming as I do from a mining community, that my chief question would be: What changes in law or administration can be made with reference to mining securities?

I am like one or two others of the committee, I am a layman, and I want to say frankly that I approach this matter with some suspicion. I come from the West, and it was out West where Mark Twain made his famous statement when he said, "A mine is a hole in the ground owned by a liar."

I personally went with a friend of mine, one time, out in the hills, and he showed me a hole in the ground and I looked down and said, "What is this?" "It is copper."

"Is it pretty rich?"

He gave me the assay on it.

"Well," I said, "what are we waiting for? Let's go down and get it. Send it down to the smelter."

"Well, it isn't rich enough for that, but it is rich enough to sell stock."

He had already sold me some, which I had found to be worthless, in another proposition.

Mr. WALTER. Is that an explanation of your suspicion?

Mr. MURDOCK. But, to get to the point—and I want to say this to Chairman Zimmerman—the mining people of the West complain that they are stopped by the regulations of the SEC and other Government regulations—

Mr. WALTER. Who registered that complaint, the kind of person that you just described?

Mr. MURDOCK. No, the small mine operator.

You see, there is no more private capital going into the mining business. The whole picture of mining is just this: That they can't get any money for opening up new mines, and where they have a venture that is something more than a mere promotional matter—

Mr. ZIMMERMAN. May I interrupt?

Mr. MURDOCK (continuing). It is this red tape that you have been talking about. A man has got to state everything, including his age and other matters, and the small mine operator thinks that it is just useless for him to go and attempt to get capital.

Mr. ZIMMERMAN. Pardon me, may I interrupt?

Mr. MURDOCK. Yes.

Mr. ZIMMERMAN. You say you lost money on one of those holes in the ground?

Mr. MURDOCK. That was many, many years ago. I was citing that case to back up Mark Twain's definition.

Mr. ZIMMERMAN. I don't know how much you lost, but you would have liked to have had some prospectuses to have stopped that, wouldn't you?

Mr. MURDOCK. That is why I have cried out, prior to the passage of these acts, the first one in 1933, I believe—I cried out against the legalized hijacking that was going on, in which they could sell any gullible person a piece of blue sky. We have got to have protection. And, I glory in the passage of legislation that would give us that protection.

Now, what I am trying to drive at is this. I see that in the mining West there is no sale of stock, it has just stopped, there is no development. Well, now, good heavens, can't we arrive at some in-between and in-between where these necessary industries can go forward, and yet the public be protected?

I heard one mining man say, "Of course mining is hazardous, more or less of a gamble."

Let's write across every mining stock certificate, "This is a gamble," in red ink, and then let the bettor take his chances.

Maybe this is permissible under some regulation, I don't know, but evidently it isn't because the mining industry needs capital—and they are crying out for it. That is exactly what I was going to take you out there for, Mr. Zimmerman, so they could tell you the story more in detail.

Mr. ZIMMERMAN. I hope they do.

Mr. EBERSTADT. Mr. Murdock, it seems to me that the extent of the disclosure doesn't necessarily depend on the number of words you use in a document. There is no one in this room that would not advocate the most complete disclosure of material necessary, but with repeated building up and duplicating and adding to it, you have not increased the disclosure, but perhaps have decreased it.

Mr. WALTER. Has much of the duplication come from people who have prepared the statement and perhaps it has been done needlessly in order to justify, perhaps, a big promotional fee?

Mr. EBERSTADT. Mr. Walter, perhaps so. It would be impossible to say "No," that no one does it, because a great many of these state-

ments are prepared by people who have not had a great deal of experience, and in their desire to do everything in the world to comply with the requirements, they do indulge in a great deal of repetition, but as I pointed out to the committee, there are certain repetitions and duplicating phrases which are not even within the power of the Commission to remedy. I want to point out that we are not talking now about a system which absolutely prevents fraud on the one hand, and on the other hand a system which would permit it. There have been very considerable frauds, even since the SEC was put into effect, and I am not blaming the SEC, because no power on earth can keep track of the unlimited ingenuity of crooks or chisellers. I need only mention the Whitney case, the McKesson-Robbins episode. I think that in an effort to sterilize the business in one sense of the term, to get every possible impurity out of it, we want to be very careful that we have not rendered the business sterile, so to say, so that worthy issues cannot be sold.

Mr. WALTER. May I ask a question?

The CHAIRMAN. Mr. Walter.

Mr. WALTER. In the fourth paragraph of this very splendid statement that you have made, you said—and I agree with you entirely:

If we are to have peacetime production, consumption, and employment levels beyond anything that we have yet achieved in this country, we will also need a volume of private investment beyond anything heretofore reached.

Now, I am just wondering, because of my connection with some small banks, what this terrific pressure of capital will do to that situation.

There isn't a savings bank in the Nation that isn't at least 100-percent liquid today. Won't the people who have deposited moneys in the banks and invested in Government securities—won't the banks themselves naturally meet the objective that you mentioned in your statement?

Mr. EBERSTADT. Well, I think the tendency would be to meet it, and I attempted to point out in the statement that those pressures are beginning to evidence themselves, but I think that no one more than my good friend, Mr. Bane, who is here, would agree with me further on this statement, if public issues reached the proportion of, say, \$16,000,000,000 per annum, this couldn't possibly go through the present sieve. That is the nub of my statement, that you must widen the mesh of that screen somewhat if you are going to get the amount of private investment—No. 1, that the business and employment need, and No. 2, that the investors will buy. You have on the one hand tremendous amounts of funds available for investment, I have never seen anything like it: you have on the other hand very great demand, people want to start new businesses, they realize the postwar period is going to be highly competitive, they want to improve their facilities.

Mr. WALTER. Isn't the real deterrent the inability of banks to make loans over a certain percentage of their capital?

Mr. EBERSTADT. I don't think that loans answer the problem, because it is a rather hazardous thing to build brick and mortar on a bank loan. You have got to get a certain balance between your invested money that doesn't come home to roost, and that you are not compelled to pay back at a particularly inconvenient period, and your bank debt.



Now, the ideal situation is that your plant and your equipment and a certain amount of working capital should be invested capital. Then, when you have peaks and valleys in inventories, handle that with your bank loans. Otherwise, you might again get into a position such as we found ourselves in, in 1929, when many companies—and again in 1921—when many companies borrowed excessive amounts, and those amounts came due and the banks were under pressure to collect them, and the vicious circle started.

The CHAIRMAN. Mr. Zimmerman, do you have any questions?

Mr. ZIMMERMAN. I am going to read the gentleman's statement. I did not have the privilege of being here this morning to hear him. As I understand it, you are advocating modifying some of the regulations of the SEC so that these matters will be handled more expeditiously; is that right?

Mr. EBERSTADT. Mr. Zimmerman, I don't even go quite that far.

In our business, we realize that we have no one to come to but you people. We feel that the acts and the regulations pursuant to those acts, as now promulgated, constitute a very serious handicap to the raising of investment capital.

Mr. ZIMMERMAN. You pointed out in your statement the things you think should be done?

Mr. EBERSTADT. In some measure.

Mr. ZIMMERMAN. That is what I wanted to know.

Mr. EBERSTADT. And all we ask you to do, may it please you gentlemen who settle national policy, is to take a look at that. We may be wrong—maybe we are—but we think it is serious enough, on the matter of postwar business and postwar employment, to justify a look by this committee.

I am somewhat familiar with the contract-termination matters and am very familiar with what your committee has done on it, and I am also somewhat familiar with surplus disposal and know what your committee has done on that. I read your reports with respect to foreign financing and think they are all excellent; but, in my opinion, you have tackled nothing of greater importance than this.

Mr. ZIMMERMAN. There is just one thought—I think we must all keep in mind—when this war is over, there will be a lot of accumulated funds in the hands of the people—savings. And these savings are going to cry out for investment, and there is going to be a spirit of recklessness in the investments of this country, and there is going to be a group in this country that will be looking out for a sucker list, such a group as we have never seen before, in my opinion. So while we want new business to come into being, to help bolster our national economy, I think we have to be careful not to turn loose a wave of wild, reckless speculation that may bring disaster somewhere down the line.

Now, it is very fine to establish a business, but it is a disaster when that business collapses, and the collapses are the things that we must guard against, if it is possible.

Mr. EBERSTADT. Mr. Zimmerman, I go the whole distance with you and simply say that all of that should be included in the investigation.

Mr. WALTER. In the investigation of the—let us call it criticism for want of a better term—of the administration of the SEC, you

mentioned the reaching out for greater power. Can you give us instances of what has been done along those lines?

Mr. EBERSTADT. Yes, sir; I think I can.

The SEC has wide discretion on what is called the waiting period. The procedure is this: You enter into a contract with the person who seeks the capital, and based on that contract you prepare and file a registration statement. That registration statement is subject to scrutiny by the SEC, and the securities cannot be offered until the registration statement is declared effective by the SEC.

Now, in the investment business, you are particularly sensitive to your markets, and that is especially true in a world like the one we are in today, where an event of tomorrow may completely change the outlook: so that when you have market conditions which are favorable, it is advantageous that you take them, so that you are naturally desirous of having that statement effective as promptly as you can have it. That power is used by the SEC, in certain respects, to accomplish things which I think the act did not intend to confer upon them.

For example, if you, as a stockholder, a controlling stockholder—and I might say that there is no word in the act vaguer than that, and the word has not been defined, and it is a very important word—but let's say you, as a stockholder, are sufficiently near "control" to be afraid to monkey with a criminal act without registering. If you want to sell those securities, or a part of your securities, and obtain a listing for the stock of that company, the SEC, under a recent regulation, will not expedite, will not accelerate, that registration unless what they regard as a fair proportion of the expenses are paid by the company itself.

Now, I don't think that that is a matter which goes to the honesty of the disclosure. The company may be perfectly ready to pay the expense, the company may obtain advantages from a public market on their securities, maybe far greater than the expenses, and it doesn't lie in the SEC's mouth, in my opinion, to influence that transaction at all, and that is an example of what I have in mind.

Mr. WALTER. In other words, by regulation the SEC has amended the law.

Mr. EBERSTADT. They have extended the scope of their jurisdiction.

Mr. ZIMMERMAN. May I interpose, Mr. Walter?

Mr. WALTER. Yes.

Mr. ZIMMERMAN. Of course, the purpose of that is to protect this man. Now, he wants to put some of his securities on the market and get a listing so that the general public will come in and buy it. That general public is made up, we know, primarily of widow women who have collected their husbands' life insurance, people who have small capital that they want to invest in something that will bring them a meal ticket, that will be money to pay rent, and it is very vital to these people.

Now, that is the general public. I think that we should be very careful before we start to limiting the authority or power of an organization that is set up to protect that group of the public, and a group in our public that needs protection. They come to rely upon these listings as something they can rely upon.

Mr. EBERSTADT. Mr. Zimmerman, it is apparent that I didn't make my point clear. I am not questioning the importance of protecting to the limit the widows whose only livelihood is the few pennies—

Mr. ZIMMERMAN. Pardon me a minute. Just the other day we were over in Chicago at some of the stockyards there, and the president of one of these stockyards handed us a list of their investors, and he pointed out that 9 out of 10 of the holders of stock in this big stockyard, the second biggest in the United States, were widow women.

Mr. EBERSTADT. May I ask you the question whether you think that a widow could understand this document [indicating prospectus]?

Mr. ZIMMERMAN. I doubt that.

Mr. EBERSTADT. I don't think so.

Mr. WOLVERTON. Mr. Chairman, may I ask a question or two at this point and make an observation?

The CHAIRMAN. Yes.

Mr. WOLVERTON. It seems to me that there is a misunderstanding as to what the securities acts really do.

It would be assumed, I think, from what my colleague, Mr. Zimmerman, has just said, that he is possibly under the impression that these securities are guaranteed or approved or passed upon as proper investments.

Mr. ZIMMERMAN. No.

Mr. WOLVERTON. By the SEC.

Mr. ZIMMERMAN. No. My position is this—let's get it clear. When once acted upon by the SEC, they have the right, then, of having these securities listed on the market.

Mr. EBERSTADT. Not necessarily.

Mr. ZIMMERMAN. I thought that was a condition.

Mr. WOLVERTON. Let me describe the two theories that were before the Committee on Interstate and Foreign Commerce when this legislation was first presented and the theory that was finally adopted.

The theories that were presented were these: First, should the Government, through the Federal Securities and Exchange Commission, pass upon a security so that it could be marked "Approved," or was it merely to gather information concerning a security, which would be available to the purchaser to determine whether he would care to invest in that particular security?

The latter is the theory of the act. The act does nothing more than require that certain information shall be filed with the Securities and Exchange Commission and that there shall be no fraud or deceit in the giving of the facts. That is all.

So that this legislation that has been referred to is a matter of public record for any possible investor to study and to look at. It is distinctly understood that by the mere granting of the right to issue that particular stock, that there is no obligation assumed, direct or indirect, morally or otherwise, by the Government, that it is a good investment. All that the Securities Act does is to collect information which is available to a possible investor.

Am I not right in that respect?

Mr. EBERSTADT. That is correct.

Mr. WOLVERTON. That was made very plain and was a clear-cut decision in the committee. All this does is provide truthful information about a company that is about to issue. Then, the persons themselves pass on it.

Now, to the extent to which anyone would come down here to Washington and study that, and how much they would be informed, I



doubt if there would be but very few investors that would ever do it, so that the changes that have been suggested by this witness at no time have gone to the point of changing the law that requires the fullest revelation of the company.

Mr. EBERSTADT. That is correct.

Mr. WOLVERTON. Isn't that your position?

Mr. EBERSTADT. That is correct. I would go even further.

Mr. WOLVERTON. The acts simply make possible the filing of the correct data and make it impossible to file untruthful statements concerning the company.

They do not object to the giving of the fullest information that is possible.

Now, the point I make is this: It doesn't require—coming back to my original point—it doesn't require an act of Congress to have that British form of registration, which is a few pages in length, adopted by the Commission, rather than that voluminous prospectus of several hundred pages. There is nothing in the law that compels the Securities and Exchange Commission to adopt a rule or regulation that requires the filing of several hundred pages to give the information that the act wishes. They could, if they wished to, this morning, without any change in the statute, adopt the form of the British, and thereby make it a very simple process, assuming that it covers the facts that they want.

This is the point that these investment brokers are objecting to, as I get it—this terrific amount of red tape and delay in getting information that could be gotten in a much simpler form and could be dealt with more expeditiously.

Mr. ZIMMERMAN. Charley, here is the way I think: It seems to me of course that widow women—take a woman who is going to invest \$10,000 collected from her husband's life insurance, possibly more or less, whatever it is—that type of woman is not coming to Washington to look at the record. Most of them are going down to see their bankers, and that ought to be in language simple enough so that that banker can, without a great deal of trouble, look it over and give her some kind of individual advice that would be satisfactory to her as an investor, because I think that is the way it should be done, and I guess it is done; but I agree with you that to wade through all of that, he would throw up his hands and say, "I just haven't got the time to do that."

Mr. WOLVERTON. But there is no one in the Commission who would say to you whether it is a good or a bad investment.

Mr. ZIMMERMAN. She will take it to a banker and ask him to tell her the story, and if it were simplified he could do it without a great deal of trouble, in my opinion.

Mr. WOLVERTON. I emphasize this, for the reason that so many seem to have an opinion that by the adoption of this act, therefore if it is on the market it is good because it had to pass through the SEC.

The SEC is not performing that function for any individual. They only collect information that is such that you may be fully aware as to what you are buying, if you are interested enough to do so.

The CHAIRMAN. I think that has been put forth in the record completely.

What is it, Mr. Walter?

Mr. WALTER. Go ahead.



The CHAIRMAN. I don't want to cut you off, sir.

I was wondering if Mr. Folsom didn't have a question or two, or a suggestion.

Mr. FOLSOM. Mr. Eberstadt, you are concerned primarily with the small issues, are you not?

Mr. EBERSTADT. Well, my firm, the business of my firm is not in what would ordinarily be called the large issues, 25-, 50-, or 100-million-dollar issues. When we started up in 1931, which was not a very happy time, not entirely from choice we confined our business to the smaller issues.

Mr. WOLVERTON. What do you mean "smaller"?

Mr. EBERSTADT. Companies with earnings of a quarter of a million to—

Mr. WOLVERTON. That is, capital?

Mr. EBERSTADT. I am talking about the companies' earnings. Their capital might run roughly from a million to six or eight million; the earnings of the companies might run from a quarter of a million to three million; the assets might run from, oh, a million and a half, up to five or six, net.

Mr. WOLVERTON. The reason I ask is, it is a fact that today, by an act recently passed, the Securities and Exchange Commission can exempt from registration issues up to \$300,000.

Mr. EBERSTADT. That is hardly an issue which would be handled nationally, Mr. Wolverton. When we get into national distribution, you have about a million—that would be about the lowest limit of a national issue.

Mr. FOLSOM. The biggest issues now, to a considerable extent, are placed privately, are they not? They don't go through the SEC at all, do they?

Mr. EBERSTADT. It is difficult to say, exactly, to what exact extent that is true. I think "considerable" is a rather strong word. I think to some extent they are placed privately.

Mr. FOLSOM. Hasn't that percentage been increasing?

Mr. EBERSTADT. In my opinion, it has stayed about the same. It is an important factor, but by no means a majority of big issues are placed that way.

Mr. FOLSOM. As I understand it, these issues that are below the million dollars, they can't get national distribution. Below that point you can depend on your local bankers and financial groups. Now, those are the particular groups that would be very much upset, I suppose, by these regulations, because they haven't the staff, as you pointed out, to compile all the necessary data.

What do those people do?

Mr. EBERSTADT. The local capital markets have just about dried up. For example, it was a very healthy thing when you had a capital market, say in Hartford, Conn., or Peoria, Ill., or other towns where the local bankers could handle a local issue. That was a very sound and excellent thing. These fellows have given up in mental and financial exhaustion.

Mr. FOLSOM. You think that would be changed if you made changes here in this, simplifying the information required?

Mr. EBERSTADT. I won't say this would be the only thing required, Mr. Folsom; this would be one step. There are a number of other steps which would have to be taken.

Mr. FOLSOM. Are you familiar with the plan promulgated by a subcommittee of the Investment Bankers Association, designed to stimulate and promote the equity of corporations in individual cities?

Mr. EBERSTADT. Yes; I am.

Mr. FOLSOM. Do you think something like that should be enacted?

Mr. EBERSTADT. I think something like that should be. That is, our local industries should be financed by local capital. You cannot get that from Wall Street; it would be financially wrong, socially wrong, it would be politically suspect. Local groups ought to handle that.

Mr. FOLSOM. Even if that were done, you would need some change in the SEC to get the issues out?

Mr. EBERSTADT. I believe it would be an advantage, but I think that the changes in the SEC which I have suggested to you today, and the more detailed changes which I will suggest, are not an answer to the very important question of financing small business. Therefore, other elements that bear on that very strongly have to be heeded—but it would be a helpful thing, put it that way.

Mr. FOLSOM. But there are really not many issues below \$300,000 nowadays.

Mr. EBERSTADT. There could be, and I think, if we were to survey the businesses in which our relatives and members of our families are engaged we would find that most of us have connections somewhere that would be in that category, because at least one-third of the business of this Nation is classed as small business.

Mr. FOLSOM. But they won't issue stock coming before the SEC.

Mr. EBERSTADT. No, they would not. I should say, if we say one-third is small business, and perhaps 20 to 25 percent is big business, the group that I am particularly concerned with is the group that lies in between. I have taken up a great deal of your time and I don't want to take up any more.

I would just like to make two general observations.

One is, that I know of no substitute for character and honesty through multiplying printed pages.

The second is, that very often the patient is ailing and it is rather difficult to find out the cause of that ailment. I fear that when we embark in the postwar period, unless we do something to free the investment capital markets, we may be sleuthing around for cures to ailments which we do not see, when this, in part, will be one of the important retarding elements. I repeat that all I am asking this committee to do is to take a look at this very important subject.

The CHAIRMAN. Are there any further questions?

(No response.)

The CHAIRMAN. Mr. Eberstadt, on behalf of this committee I want to thank you for your appearance here today, and your very frank discussion, and we shall appreciate the suggestions that you have, about how the matter might be clarified.

Mr. EBERSTADT. I am glad to have had the opportunity, Mr. Chairman.

The CHAIRMAN. Thank you.

The committee will now adjourn until further notice.

(Whereupon, at 12:50 p. m., the committee adjourned subject to the call of the Chair.)

# EXHIBITS

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## EXHIBIT 1

### SUPPLEMENTAL STATEMENT FILED WITH THE COLMER COMMITTEE ON POSTWAR ECONOMIC PLANNING AND POLICY

By ERNEST G. DRAPER, *Board of Governors of the Federal Reserve System*

*I. What are likely to be the needs of business for short- and medium-term credit in the transition and early postwar period?*

The important question is not the amount of postwar credit, but the assurance that what is needed will be made available. We are confronted with a mixed situation. The financial position of business as a whole has improved during the war and many businesses undoubtedly have ample liquid resources to finance their reconversions without borrowing. On the other hand, individual cases and special situations are foreseen in which there will be an especially acute need of credit. Planning, accordingly, should center upon providing credit in the area of acute need and relatively high risk. A system enabling the banker to obtain partial insurance-type protection behind his more extreme credit risks fits the practical requirements of the prospective situation and also conforms to the need of maintaining private enterprise in the credit system.

#### *Present high level of business savings*

Many businesses, large and small, have enjoyed prosperity during the war and have greatly improved their financial positions. A survey of financial statements of nearly 2,000 business concerns of various sizes—1,260 in manufacturing and 681 in trade—was recently made by the research staffs of the Federal Reserve System in corporation with the Robert Morris Associates. While this is but a small sample of the entire business field and is clearly recognized as such, the sample is believed to be fairly typical with the possible exception of the very small firms—those with less than \$50,000 assets. Three tables from the study are shown here.

Sales of the manufacturing enterprises were found (table 1) to have increased 121 percent for 1943 as compared with 1940. In the field of wholesale and retail trade, the gain in sales was less than in manufacturing, averaging 53 percent. While there has been considerable variation in the increases in different industries the average wartime expansion has been about the same for small as for large business.

Among the subdivisions of manufacturing (table 2) the gains in sales varied widely, as might be expected from the varying demands of the war effort. The smaller concerns showed by far the highest rates of sales increase in 9 industries—textile mill products, apparel, paper products, chemicals, steel and its products, electrical equipment, machinery, transportation equipment, and stone, clay, and glass products. Medium-sized concerns had the largest gains in three industries—food processing, lumber and its products, and printing. The large concerns had the highest sales gains in beverages, leather, petroleum, and rubber products.

The wartime growth in sales has been accompanied for many businesses by large increases in retained profits and, as a consequence, sharp increases in net working capital, that is, the excess of short-term assets over short-term liabilities. This has meant a very appreciable strengthening of business financial positions. Holdings of liquid assets—that is, cash and marketable securities—have increased very greatly in most lines of manufacturing and trade (table 3). In manufacturing, the increase among the large companies appears for the most part to have represented higher operating requirements, since their liquid assets rose by about the same percentage as their sales. Among the smaller

manufacturers and among trade concerns of all sizes, however, liquid balances have risen much more than sales; this suggests the presence of considerable idle funds in most lines.

TABLE 1.—*Percentage increase in sales, 1940-43, for sample of manufacturing and trade concerns, by size of business*<sup>1</sup>

Asset size (in dollars)	Manufacturing		Trade	
	Number of concerns	Percentage increase in sales	Number of concerns	Percentage increase in sales
Under 50,000 .....	14	50	22	58
50,000 to 100,000 .....	33	150	51	81
100,000 to 250,000 .....	100	115	140	53
Under ¼ million .....	147	117	213	56
¼ to 1 million .....	296	116	260	45
1 to 5 million .....	389	120	161	62
5 to 10 million .....	95	107	24	47
10 million and over .....	333	121	23	55
All sizes .....	1,260	121	681	55

<sup>1</sup> The classification of business in terms of total assets in this and following tables indicates size as of the end of 1941.

Table from January Federal Reserve Bulletin, p. 18.

TABLE 2.—*Percentage increase in sales, 1940-43, for sample of manufacturing and trade concerns, by industry and size of business*

Industry	Asset size (in millions of dollars)		
	Under 1	1 to 10	10 and over
<b>MANUFACTURING</b>			
1. Greatest sales increase among small concerns:			
Textile mill products .....	116	99	104
Apparel .....	78	60	
Paper and products .....	79	43	44
Chemicals and products .....	95	72	75
Stone, clay, and glass products .....	105	28	46
Steel and products .....	131	102	99
Electrical equipment .....	474	334	195
Machinery .....	318	259	183
Transportation equipment .....	701	331	246
2. Greatest sales increase among medium-size concerns:			
Food .....	89	98	82
Lumber and furniture .....	55	61	54
Printing and publishing .....	44	51	42
3. Greatest sales increase among large concerns:			
Beverages .....	89	54	145
Leather and products .....	53	59	66
Petroleum and rubber .....	62	77	86
	Under ¼	¼ to 1	1 and over
<b>TRADE</b>			
1. Greatest sales increase among small concerns:			
Wholesale:			
Food, beverages, tobacco .....	93	63	70
Steel and products .....	53	47	14
Electrical equipment .....	74	-4	(1)
Machinery and equipment .....	181	89	92
Retail:			
Automobiles .....	-67	-76	(1)
Furniture .....	30	4	16

<sup>1</sup> Less than 5 companies tabulated.



TABLE 2.—Percentage increase in sales, 1940-43, for sample of manufacturing and trade concerns, by industry and size of business—Continued

Industry	Asset size (in millions of dollars)		
	Under 1	1 to 10	10 and over
TRADE—continued			
2. Greatest sales increase among medium-size concerns:			
Wholesale:			
Paper and products.....	62	67	(1)
Automotive.....	-39	-25	(1)
Retail:			
Food, beverages.....	47	87	54
Department stores, dry goods, apparel.....	55	62	60
Lumber, fuel, ice.....	31	66	47
3. Greatest sales increase among large concerns:			
Wholesale:			
Lumber, coal.....	26	6	76
Textile products, apparel.....	101	80	105

<sup>1</sup> Less than 5 companies tabulated.

NOTE.—A different definition of small, medium, and large is used for trade than for manufacturing in recognition of the greater proportion of the trade business done by concerns with small assets and the comparative scarcity of concerns in the largest asset classes.

Table from January Federal Reserve Bulletin, p. 19.

TABLE 3.—Percentage increase in cash and marketable securities, 1940-43, for sample of manufacturing and trade concerns, by size of business

Asset size (in millions of dollars)	Manufacturing		Trade	
	War industries	Other	Wholesale	Retail
Under ¼.....	383	301	300	367
¼ to 1.....	534	275	281	346
1 to 5.....	537	251	257	390
5 to 10.....	455	190	266	193
10 and over.....	137	99		

NOTE.—Based on year-end figures. Industries classified as "war" include metal and metal products, chemicals, petroleum and rubber. Figures from April Federal Reserve Bulletin, p. 313.

As a result of this generally favorable experience during the war, many businesses undoubtedly will be able to retain liquid resources ample to enable them to go through the reconversion period without borrowing. This will obviate much of the need for credit.

#### *Broad areas of prospective credit need*

On the other hand, not all businesses have profited equally—the war prosperity has not been evenly spread. The study referred to above shows that the war industries—manufacturers of metal and metal products, chemicals, petroleum, and rubber—had relatively much greater increases in sales and assets than other manufacturers, and greater than the wholesale and retail trade groups.

Two great industries, the automotive group with its many related trade, service, and tourist enterprises, and the nonwar construction industry, have been in abeyance and account for the temporary disappearance or decline of many business concerns. Many businesses that have continued throughout the war in their peacetime lines have at the present time depleted inventories, run-down equipment, and disrupted civilian markets. The revival and reconversion to peacetime operations of such enterprises will require considerable credit, especially of the medium- or long-term loan type. Their ability to furnish loan collateral commensurate with their financial requirements is in doubt, even though their business prospects and ability to perform may be satisfactory. Their credit applications accordingly will require supplementing by a partial credit guaranty, which increases the element of security behind their bank loans.

Similar is the prospective credit situation of war enterprises which have not done well during the war, new businesses, and old businesses experimenting in new types of production.

#### *Special credit needs and problems*

Many war industries will be faced with special credit problems immediately upon contract cancellation.

1. There will be cases in which postwar reserves exist on paper but are not sufficiently present in liquid form. Many enterprises, immediately upon completion or termination of their last war contracts, will shut down for a period of retooling, replacement of worn out or obsolete machinery, procurement of new materials and inventory, rebuilding of sales staffs, and general readjustment. A period of breaking in to the reconverted lines of activity will follow, along with a struggle for markets. All this will exert an unusually large drain upon cash resources.

2. Another special situation is that of the subcontractor in the third, fourth, or fifth tier of production, who may have to wait for his payment until a prime contractor, or a subcontractor in an upper tier, straightens out his affairs and passes the payment down. One failure in an upper tier may embarrass a considerable number of subcontractors lower down, and this has been referred to as the "ninepins situation." Cases of this sort have already occurred. In one, a prime aircraft contract on the Pacific coast was terminated, an airplane motor manufacturer on the Great Lakes sustained a contract cut-back in turn, and a small parts maker who had produced ahead of actual orders on a single part was caught with \$40,000 of useless inventory on hand and a V loan falling due. This particular emergency was met by special arrangements, but the situation may multiply as contract terminations become general. Although the Contract Settlement Act provides for direct settlement of subcontractors' claims by the procurement agencies, and the problem is recognized and is under study, it appears likely that many of these temporary periods of financial stringencies must be bridged by some form of credit.

3. Another special type of situation is that of the war manufacturer who desires to buy Government-owned machinery that is already in the plant, or inventory left under a canceled war contract, but may be unable to make the entire purchase from internal resources or as part of the final contract settlement. The machinery may be of a type useful to the enterprise in its future production, and the inventory may and often does consist of some special or patented product which the company urgently desires to keep out of competitors' hands. One small independent electric-equipment company, for example, has invented an electrical device that has become established during the war. In order to fill all orders promptly, surplus inventory has been kept on hand. Assuming a termination of war orders, this inventory must be acquired by the producer directly from the procurement agency, or in time be declared surplus war property and disposed of by the Surplus Property Board in accordance with the Surplus Property Act. Should the company's own resources be insufficient, credit must be obtained.

In these three special situations, any credit needed by war contractors can probably best be provided by the local banks, inasmuch as most of the contractors have been borrowers at banks during the war, and their bankers are consequently already familiar with their individual credit problems. The possible effect upon the bank credit of an enterprise owing a primary debt to a Government agency is also to be considered. It is preferable from the point of view of the business enterprise for its bank to extend both the short-term credit and the term loan. Thus the banker can weigh the entire situation in considering the credit needs of the borrower. The need for both long-term and short-term credit is likely to be a common one in the reconversion period, when business as a whole must modernize plant and equipment in order to compete in the postwar market. Banks should be encouraged to assume this double credit position by making available to them a partial protection of their lending risks.

4. Another special problem arises from the wartime balance sheets of businesses, which are generally abnormal, judged by prewar standards. In determining the credit to be extended, banks are customarily guided by the balance sheet of the prospective borrower. Concerns in war industries have expanded, in many

cases phenomenally, and the expansion has been financed to an unusual extent through an increase in short-term liabilities. The smaller expansion of concerns in nonwar industries, on the other hand, has been generally accompanied by some liquidation of short-term liabilities. These and other wartime changes have distorted the distribution of business assets and liabilities into more or less unfamiliar proportions. Uncertainty of bankers and others in interpreting the customary comparisons, such as the ratio between current assets and current liabilities, can easily add to the general uncertainty of the credit situation. This type problem is illustrated by the case of a certain metal foundry, launched on \$25,000 of investment back in 1914. Capital investment had grown to \$350,000 by 1938, during which year the company had \$449,000 in sales. An alloy developed by this concern proved highly valuable for wartime use, and in 1944 sales had grown to almost \$20,000,000, or about 40 times as much as in 1938. Meanwhile, a \$965,000 plant expansion plus additional working capital requirements had to be financed, so that a \$4,000,000 V loan was made. The balance sheet of such a concern, as reconversion begins, may be expected to show current liabilities high in ratio to capital investment, and current assets, while also high, reduced in ratio to current liabilities. Also of importance is the banker's problem in having to estimate what part of the present sales volume will remain to such a company after the war and how much credit can be soundly provided. The abnormal balance sheet and the difficulty of estimating the sales prospect, multiplied many times, constitutes one of the more serious credit problems of reconversion.

5. Closely related to this problem is the postwar credit rating of the war enterprises which have not done well during the war and of the purely civilian enterprises that have not participated in the general prosperity. Although there are many external reasons why certain individual businesses and types of business have not been prosperous during the war, the contrast between them and the profits-making group will be especially evident, and the inference may be that they have been mismanaged where this is not actually the case.

All these types of special situations present reconversion risks that both require and in general justify a partial insurance coverage of the lending risk of a private lending institution.

11. *Does recent experience of the Federal Reserve System with section 13b and regulation V loans suggest any facilities or procedures that might be useful in meeting credit needs of the postwar period?*

Eleven years of experience with loans to business under section 13b, together with 3 years of experience with guaranteed war-production loans under regulation V have well demonstrated that, protected by the partial guaranty against loss, a bank will lend and lend freely to small enterprises and other types of borrowers whose credits are in the marginal area of risk.

#### *Prewar experience in bank loan guaranty*

Congress in 1934 added section 5d to the Reconstruction Finance Corporation Act and section 13b to the Federal Reserve Act. The two amendments were fundamentally similar, in enabling the respective agencies to make (a) direct loans, (b) loans in participation with private lending institutions, and (c) commitments regarding the loans of private lending institutions to business and industry. The third or commitment feature developed into the form of underwriting of private loan risks that is variously known as the partial take-out agreement, the deferred participation, the loan purchase agreement, bank loan insurance, or bank loan guaranty. This feature will be discussed in terms of its essential feature—as a loan guaranty plan.

This is the plan which has proved, in 11 years of experience, to be the best both in practice and in theory. Of 2,911 loans, totaling \$192,000,000, authorized under section 13b, in the 6 years ending May 31, 1940, 1,140, amounting to \$97,000,000, were guaranteed (table 4). Of these guaranteed loans, 322, amounting to \$26,000,000, were either withdrawn or expired unused; while 818 loans, amounting to \$71,000,000, required some advances of funds by Federal Reserve banks. Such advances, however, amounted to only \$9,000,000, which was used to take over loans from the lending institutions which had previously made the entire loan. Thus, under the guaranty plan, for \$1 of Federal Reserve funds employed, nearly \$8 of private bank credit was extended.

TABLE 4.—*Industrial loans by Federal Reserve banks under sec. 13b of the Federal Reserve Act, June 19, 1934, to May 31, 1940*

[Amounts in thousands of dollars]

	Total loans authorized		Loans involving no advance by Reserve banks <sup>1</sup>		Loans involving advance by Reserve banks		
	Number	Amount	Number	Amount	Number	Credit authorized	Federal Reserve advances
Total.....	2,911	192,206	884	47,281	2,027	144,925	62,507
Direct loans.....	1,299	53,903	404	14,216	895	39,688	36,028
Joint loans <sup>2</sup> .....	472	41,601	158	7,476	314	34,125	17,183
Commitments (guaranties) <sup>3</sup> .....	1,140	96,701	322	25,589	818	71,112	9,296

<sup>1</sup> Approved loans subsequently withdrawn and unused guaranties.<sup>2</sup> Loans made in part by Federal Reserve banks and in part by private financing institutions.<sup>3</sup> Commitments of Federal Reserve banks to take over loan made by private financing institutions and to assume losses up to 80 percent of the loan.

NOTE.—These figures are based on a special tabulation of industrial loans and are on a slightly different basis from the regular monthly figures shown in the Federal Reserve Bulletin. This accounts for the slight difference in totals shown here and for May 29, 1940, in the July 1940 Bulletin, p. 689.

The usefulness of the guarantee plan to the small business borrower is shown in the fact that, to borrowers with less than \$50,000 in total assets, the average direct loan was \$3,800, the average loan made jointly with a financing institution was \$5,100, and the average guaranteed bank loan was \$6,700 (table 5). In all size brackets the average amount of guaranteed loan considerably exceeded the average amount of direct loan, while the joint loans showed an emphasis upon the largest size bracket.

The 13b guaranteed loan was limited by the statute to an 80-percent coverage of the bank risk, to established enterprises, and by restrictions as to purpose and maturity of the loan. These restrictions limited the usefulness of the guarantee plan in the prewar period and may be more serious under the conditions expected to be encountered in the readjustment period. The proposed amendment (the Wagner-Spence bill, S. 511 and H. R. 591) eliminates direct lending and lending in participation with banks from section 13b and broadens the scope of the guarantee plan so as to make that plan more fully applicable to the anticipated postwar credit needs and conditions.

#### *Guaranteeing of war-production credits*

The war-loan-guaranteeing program established by Executive Order 8112 and conducted under regulation V of the Board of Governors of the Federal Reserve System has made available 9.5 billion dollars of private bank credit for war production, and has been the culminating proof of the validity of the guarantee principle. On June 30, 1944, two-thirds of the outstanding loans of commercial banks for war purposes were guaranteed V loans (table 6).



TABLE 5.—*Industrial loans under sec. 13b of the Federal Reserve Act in which Federal Reserve bank funds were advanced, by type of loan and by size of borrowing enterprise, June 19, 1934, to May 31, 1940*

[Amounts in thousands of dollars]

Type of loan	Total loans involving advances	Borrowers with total assets of—			
		Under \$50,000	\$50,000 to \$250,000	\$250,000 to \$1,000,000	Over \$1,000,000
Number of loans:					
Total, all types.....	2,027	448	779	526	274
Direct loans.....	895	264	350	169	112
Joint loans.....	314	559	127	83	45
Commitments (guarantees) <sup>1</sup> .....	818	125	302	274	117
Amount authorized:					
Total, all types.....	144,925	2,156	16,639	39,209	86,921
Direct loans.....	39,688	1,012	6,419	9,793	22,464
Joint loans.....	34,125	302	3,082	6,169	24,571
Commitments (guarantees) <sup>1</sup> .....	71,112	842	7,137	23,247	39,886
Average amount authorized:					
Total, all types.....	71.5	4.8	21.4	74.5	317.2
Direct loans.....	44.3	3.8	18.3	57.9	200.6
Joint loans.....	108.7	5.1	24.3	74.3	546.0
Commitments (guarantees) <sup>1</sup> .....	86.9	6.7	23.6	84.8	340.9

<sup>1</sup> Commitments of Federal Reserve banks to take over loans made by private financing institutions; omitted are 322 guarantees of bank credit amounting to \$25,589,100 which were either withdrawn or expired without advance of Reserve bank funds.

NOTE.—This table excludes approved loans subsequently withdrawn and guarantees which were unused. For these figures, see table 4.

TABLE 6.—*War loans outstanding at all commercial banks*

[Amounts in millions of dollars]

Call date	Loans for war purposes outstanding at all commercial banks (estimated) <sup>1</sup>	Regulation V guaranteed loans outstanding	Percent of total war loans under regulation V
1941—Dec. 31.....	1,300	-----	-----
1942—June 30.....	2,250	81	4
Dec. 31.....	2,950	804	27
1943—June 30.....	3,250	1,428	44
Dec. 31.....	3,500	1,914	55
1944—June 30.....	3,150	2,064	66
Dec. 31.....	3,200	1,736	54

<sup>1</sup> Estimates of the Board of Governors based largely on statistics collected and released by the American Bankers Association.

Under this program from its inception in April 1942 to March 31, 1945, authorities of guaranteed loans totaling 9.5 billion dollars were granted to a total of 4,313 borrowing enterprises (table 7). The borrowing enterprises were manufacturing, construction, and other companies whose products or services were considered by the War Department, Navy Department, and Maritime Commission to be necessary to the war. The funds advanced under these authorizations were those of private lending institutions. The average guarantee of the bank risk was approximately 85 percent.

About 7.7 percent of the borrowers under regulation V were large enterprises whose total assets at the time of their first V loan amounted to \$5,000,000 or more. An additional 28.6 percent of the borrowers were enterprises with total assets of \$500,000 to \$5,000,000. But the lower-size brackets, below \$500,000 in total assets when the first V loan was made, accounted for 62 percent of

all borrowers. These relatively small borrowers, probably averaging in terms of employment approximately 150 workers or less to begin with, received total authorizations of commercial bank credit amounting to \$835,000,000. The average amount of bank credit authorized to 1,848 small borrowers with \$50,000 to \$500,000 total assets was \$108,700, and the average authorization to the 825 smallest borrowers, with less than \$50,000 in total assets, was \$96,900. This performance of private lending institutions in behalf of small business engaged in war production indicates the effectiveness of the loan-guaranteeing plan.

TABLE 7.—*War-production loans guaranteed under regulation V to Mar. 31, 1945, by asset size of borrower*

[Amounts in thousands of dollars]

Asset size of borrower	Number of borrowers	Percent of total	Amount of loans guaranteed	Average amount per borrower
Total.....	4,313	100.0	\$9,471,084	\$2,195.9
Less than \$50,000.....	825	19.1	79,945	96.9
\$50,000 to \$500,000.....	1,848	42.9	755,350	408.7
\$500,000 to \$5,000,000.....	1,235	28.6	2,078,354	1,682.9
\$5,000,000 and over.....	333	7.7	6,510,360	19,550.6
No information on size.....	72	1.7	47,075	653.8

NOTE.—This tabulation, based on guarantee agreements executed to Mar. 31, 1945, is on a different basis from the regular monthly figures shown in the Federal Reserve Bulletin. The total number of loans exceeds the total number of borrowers because many borrowers had more than 1 loan. Classification by size is based on total assets at about the time of first loan approval.

Some enterprises in the smaller asset size groups expanded remarkably in response to the abundance of credit extended under regulation V. Among the 825 borrowing enterprises having less than \$50,000 in total assets when their first V loan was made, 119 ultimately received maximum credit authorizations of \$50,000 to \$100,000 in credit, 46 received \$100,000 to \$250,000, and 29 received authorizations of \$250,000 and over (table 8). Among the 1,848 enterprises initially in the \$50,000 to \$500,000 total assets class, 314 received maximum credit authorizations of \$250,000 to \$500,000, 104 received \$500,000 to \$1,000,000, and 30 received authorizations of \$1,000,000 and over. These were cases in which the performance of the enterprise resulted in additional war contracts and in repeated increases of the maximum allowance of bank credit. Such increases could not have been made without the supporting credit guaranty.

Experience under regulation V has helped to liberalize the standards of credit risk acceptance. The credit officials of the Federal Reserve banks had had the experience of section 13b operations to build on. In the case of the smaller V loans, which were in many cases made by relatively small- and medium-sized banks, the Reserve banks have acted in an advisory relationship in working out loan contracts and credit terms, and loans have been "tailored" to fit the particular case. New types of loan security have been found, old formulas have been abandoned, and the ability of an enterprise to perform and produce has been regarded as a major credit consideration. Emphasis has been placed upon sound managerial practices, standard accounting procedures, limits on dividends and on withdrawals by proprietors and on executive salaries, and other provisions and programs for the financial improvement of the borrowing enterprise. When borrowers have difficulties the same helpful advisory attitude exemplified in setting up the loans has been shown.

TABLE 8.—*Number of borrowers with war-production loans guaranteed under regulation V to Mar. 31, 1945, by asset, size of borrower, and by maximum loan guaranteed*

Maximum loan guaranteed	Borrowers with total assets of—				
	Less than \$50,000	\$50,000 to \$500,000	\$500,000 to \$5,000,000	\$5,000,000 and over	No information
Less than \$25,000.....	423	128	4	-----	4
\$25,000 to \$50,000.....	208	235	4	-----	7
\$50,000 to \$100,000.....	119	495	33	-----	11
\$100,000 to \$250,000.....	46	542	157	2	16
\$250,000 to \$500,000.....	21	314	334	3	18
\$500,000 to \$1,000,000.....	5	104	333	16	3
\$1,000,000 to \$5,000,000.....	3	28	356	152	13
\$5,000,000 and over.....	-----	2	14	160	-----
Total.....	825	1,818	1,235	333	72

NOTE.—In the case of borrowers with more than 1 guaranteed loan, classification is on the basis of the maximum loan; this figure is smaller than the aggregate amount of all guaranteed loans to that borrower. Classification by size is based on total assets at about the time of first loan approval.

In one case a 90-percent guaranty enabled a bank to loan \$100,000 at 4 percent interest to a small manufacturer of diving equipment whose bank credit previously had not exceeded \$15,000. The company expanded, its sales increasing from \$73,000 in 1942 to \$340,000 in 1943 and its equity capital from \$9,200 to \$56,000 during the same period. Then production trouble occurred and the V loan became delinquent, but the bank stood by, requesting and receiving an extension of the guaranty. The trouble was overcome, and in 1944 the company's sales reached \$1,000,000, its capital mounted to \$90,000, and the V loan was repaid in full. Without the guaranty, there might well have been a foreclosure.

In another case a small concern with \$163,000 equity capital, making Army raincoats, received a \$600,000 V loan under a 90-percent guarantee. Sales for 1942 exceeded \$1,000,000, but then came production trouble, goods were rejected, and in 1943 sales declined to \$700,000. Instead of calling the loan, the local bank and the Federal Reserve bank at the end of this bad year suggested an increase of the guaranteed credit to \$1,000,000 and a reduction in the interest rate to 3½ percent. The guaranteeing agency consented, the enterprise improved its production process, and in the first 8 months of 1944 sales exceeded \$2,500,000 and the \$1,000,000 V loan was retired. The proprietor of this business wrote the following letter to an official of the Federal Reserve bank:

"Now that we have repaid our V loan, I am giving way to the impulse to write you of our appreciation for the kindness and understanding you showed when, through force of circumstances, we were declared delinquent on the loan.

"The confidence you expressed in our ability to work out of our trouble was just the lift we needed, and we were happy we were able to prove that this confidence was not misplaced."

An interesting case was that of a veteran lumberman who, though he knew well the production end of the business, had an unsatisfactory business record. He had an opportunity to cut lumber for Army use, and a small rural bank lent him \$50,000 under a 99-percent guaranty, with no security other than the war contract, but with a loan agreement which virtually made the bank the financial agent of the business. Thus financed, the man bought the necessary equipment, produced 2,300,000 feet of lumber for the Army stock pile, and earned a profit sufficient to repay the loan. The bank has since made loans to this lumberman on other war contracts without a guaranty.

#### *Discontinuance of the V-loan system*

The protection of bank-credit risks under regulation V, including the V, VT, and T loans, will be lost by each lending bank individually as part of the process of termination and settlement of the borrower's final war contract or subcontract. This process is already underway. The V loan is generally secured by pledge of the receipts from war contracts, and the T loan represents an advance against the claim arising from terminated war contracts and must be retired when the settlement is made. This will leave many businesses without adequate

credit at a most critical stage, that of physical reconversion and initial search for civilian markets.

Under the terms of the Wagner-Spence bill (S. 511 and H. R. 591), a new form of credit guaranty would be immediately available to replace the retired V loan or T loan of enterprises which have been engaged in war production. Thus, interruption to the credit status of the enterprise at its bank would not necessarily occur at this critical time. For many nonwar enterprises that have not had V-loan protection and must prepare for peacetime conditions, the assurance of adequate bank credit that is provided by the guaranteeing of bank-loan risks is essential if they are to survive. The reconversion period will be beset by many difficulties, but a lack of adequate credit to worthy business enterprises should not be one of them.

## EXHIBIT No. 2

### FOREWORD TO REPORT ON CONFERENCES WITH THE SEC AND INVESTMENT BANKERS ASSOCIATION OF AMERICA

On May 14, 1940, Senator Prentiss M. Brown, of Michigan, introduced in the Senate of the United States a bill (S. 3985) to amend the Securities Act of 1933, as amended, and to amend section 264 of the Bankruptcy Act. An identical bill (H. R. 10013) was introduced in the House of Representatives on June 6, 1940, by the Honorable Clarence F. Lea, of California.

On May 17, 1940, Congressman Lea introduced in the House another bill (H. R. 9807) proposing to amend the Securities Act by extending the exemption in section 3 (b) so as to permit the Securities and Exchange Commission to exempt issues from the registration requirements of the act where the aggregate amount at which the issue is to be offered to the public does not exceed \$1,000,000. An identical bill (S. 4006) was introduced in the Senate on May 20, 1940, by Senator Johnson, of California.

Both of the bills which had been introduced in the House (H. R. 9807 and H. R. 10013) were referred to the House Committee on Interstate and Foreign Commerce, which requested the Securities and Exchange Commission for its comments thereon. Mr. Lea, chairman of the House Committee on Interstate and Foreign Commerce, made arrangements for hearings on these bills to take place before his committee on the general subject of the Securities Acts.

Following this, Mr. Jerome N. Frank, then Chairman of the Securities and Exchange Commission, wrote to Mr. Lea on June 17, 1940, as follows:

"DEAR MR. LEA: The Commission has before it your messages of May 20 and June 10, enclosing copies of H. R. 9807 and H. R. 10013 embodying proposals for amending the Securities Act of 1933, asking for such comments as we may desire to make.

"While we intend to proceed as promptly as possible, we respectfully request that we be given until January 1941 to file our comments and recommendations. There are several reasons which support this request. The subject matter of the bills is of such scope and importance, and requires such careful consideration, that much time is necessary to permit painstaking study of the merits of the proposals. In addition, these bills should be weighed in connection with such suggestions of our own as we may wish to offer. The National Association of Securities Dealers, through its chairman, has already been conferring with us on the subject of amendments to the Securities Act. Furthermore, the Commission is aware that the Investment Bankers Association of America and certain representatives of the stock exchanges are also interested in changes in the Securities Act of 1933 and in the Securities Exchange Act of 1934. Because of the close relation between the Securities Act of 1933 and the 1934 act, it seems advisable to consult with the investment banking and dealer associations and those exchange representatives before setting forth our views on your bills. We think it is important that time should be allowed for such conferences between ourselves and such members of the industry as may wish to confer with us.

"We think the postponement we suggest will, in the end, serve the convenience of everyone involved. It will save time if, in advance of the consideration of the various proposals by Congress, the areas of agreement and such disagreements as may arise between ourselves and the industry are delineated as definitely as possible.

"I am sincerely and respectfully yours,

"JEROME N. FRANK, *Chairman.*"



Mr. Emmett F. Connelly, president of the Investment Bankers Association, also wrote to Mr. Lea, under date of June 19, 1940, saying:

"DEAR CHAIRMAN LEA: Through your courtesy, I have seen a copy of the letter dated June 17, 1940, which Jerome N. Frank, Chairman of the Securities and Exchange Commission, wrote to you, requesting that the Commission be given until January 1, 1941, to file their comments and recommendations on H. R. 9807 and H. R. 10013 embodying proposals for amending the Securities Act of 1933.

"It seems to us that the Commission's suggestion of sitting down with representatives of the various stock exchanges and of the investment banking industry in order to work out appropriate amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934 for presentation to Congress is a most constructive one. We are delighted with this opportunity and I can assure you that this association will do everything in its power to cooperate in working out proper amendments to these acts in order to speed up the flow of capital into industry and make capital available to numerous industries which are vital in our defense program.

"On behalf of this association, I, therefore, concur heartily in the Commission's suggestion to you.

"Respectfully yours,

"E. F. CONNELLY."

Following this, a series of conferences on the subject of the "waiting period" under the 1933 act took place with the Commission in Washington on June 24 and 25 and again on July 2 and 3, 1940. Representatives of the National Association of Securities Dealers, Inc., and of the Investment Bankers Association of America participated in these conferences, during which an agreement was reached as to the text of a proposal to be recommended to the Congress to amend section 8 (a) of the 1933 act. This proposal was embodied in H. R. 10276, which was introduced into the House of Representatives on August 1, 1940, by Mr. Lea, of California. It was subsequently attached to the bill then before Congress to provide for the regulation of investment companies and, as title III of that statute, it became law on August 22, 1940.

The conferences which took place with the Commission and its staff in June and early in July 1940 dealt solely with the problem of the "waiting period" under section 8 (a) of the 1933 act. No further amendment of this section is being proposed.

So as to facilitate the working out of the conferences with respect to other proposals for amending the 1933 and 1934 acts, as arranged with Mr. Lea and Mr. Frank, representatives of the Investment Bankers Association of America, the National Association of Securities Dealers, Inc., the New York Stock Exchange and the New York Curb Exchange, met on July 31, 1940, and initiated a series of discussions among themselves, as a result of which they had on August 30, 1940, developed a number of recommendations representing their views as to necessary and desirable changes in the two acts.

In these conferences the representatives of the two associations and of the two exchanges have sought only to make the Securities Act of 1933 and the Securities Exchange Act of 1934 more equitable and to modify their provisions governing procedures so as to make it possible to transact business more efficiently without impairing the protection afforded to investors by the requirement of fair and adequate disclosure of information as to the character of securities offered or sold to the public. They strongly support the principle that the Federal laws should adequately safeguard the investor against fraudulent transactions. In examining the existing laws and in putting forward suggestions for amendments thereto, the representatives of the industry have sought to facilitate the resumption of private investment and the flow of idle money into industry through the simplification of procedures and by the removal of those restrictive provisions, unnecessary for the protection of investors, which have impeded the exchanges and the private capital market from functioning efficiently in the public interest.

The first conference on the general program took place in Washington on October 17 and 18, 1940. The Securities and Exchange Commission was represented by the heads of certain of its divisions and by other members of its staff. A further conference between the representatives of the industry and members of the SEC staff took place in Washington on October 31 and November 1, 1940. Similar conferences occurred on December 4 and 5 and December 17 and 18, 1940, and again on January 6 and 7, 1941.

The first conferences in which the Commissioners themselves participated with the representatives of the industry took place on January 23, 1941. Further conferences between the representatives of the industry and the Commission and its staff took place on February 10 and 11, 1941, at which time it was arranged that the proposals which up till then had been explored only in general terms, should be drafted into statutory language for further consideration. Representatives of the industry worked with members of the SEC staff in making these drafts. The first series of conferences with the Commission to consider the statutory drafts took place on March 31, April 1, and April 2, 1941. Further conferences with the Commission took place on April 7 and 8, 11 and 18, and on May 6 and 7. On June 4, first drafts were exchanged of the Commission's report and of this report. These reports were the subject of conferences with the Commission and its staff on June 9 and 10 and again on June 17. A revised draft of this report, dated June 19, was sent to the Commission on June 20 and the second draft of the Commission's report was received by the representatives of the industry on July 9, 1941.

Up to and including June 17, the conferences in Washington had occupied all or a substantial portion of 38 business days. The proposals presented in this report were the subject of discussion in these conferences. An explanatory statement and an outline of the position taken by the conferees with respect to each proposal which is being put forward accompanies each draft amendment as presented in the following pages. The position taken by the Commission with respect to each of these proposals as shown in this report is that indicated by the Commission's draft report of July 7, 1941, which was the latest draft available to the representatives of the industry up to the date of this report.

All of the present provisions of the Securities Act of 1933 and of the Securities Exchange Act of 1934 were examined during the conferences. H. R. 4344 introduced by Representative Wadsworth on April 14, 1941 and H. R. 5065 introduced by Representative Paddock on June 16, 1941, have not been discussed in the conferences.

Among the provisions of the act discussed in the conferences, without resultant proposals for amendment, were subsection 9 (a) (2) of the 1934 act, while prohibits manipulation of security prices, and subsection 9 (a) (6) of the same act, which is concerned with the pegging, fixing, and stabilizing of such prices. The representatives of the industry called attention to the difficulties and uncertainties arising from the broad language of these subsections. As a result of these discussions, attempts to rewrite these provisions were dropped in favor of an approach which promises to result in the clarification which is desired. The Commission expressed its willingness to issue wherever practicable interpretive rulings or reports on the applicability of the statute to situations which are presented to it. It is hoped that through the issuance of such reports a body of precedent will be developed which will enable persons to avoid inadvertent violations of the statute.

The representatives of the industry and the Commission have advised one another that the proposals contained in the drafts presented in this report are the only proposals for amending these two acts which the Commission or the conferees representing the industry intend to recommend to the Congress or support in connection with the present program for amending the Securities Acts.

The representatives of the industry desire to record their appreciation of the consideration which has been given to their proposals by the Securities and Exchange Commission, and by the members of the Commission's staff.

In his letter of June 17, 1940, Mr. Frank expressed the view to Mr. Lea that it would save time if, in advance of consideration of proposed amendments by Congress, the areas of agreement and such disagreements as might arise between the Commission and the industry could be delineated as definitely as possible.

While agreement has been reached on many points, others remain, including several important questions, on which opposing points of view must be presented to the Congress. It is particularly disappointing to the representatives of the industry that it has not been possible to reach an agreement with the Commission as to section 5 of the 1933 act. As to this and other major questions, they have tried earnestly throughout a period of several months to arrive at reasonable bases of agreement which would fully safeguard investors without unnecessarily impeding the conduct of honest business. It is the view of the representatives of the industry that proper recognition has not been given by the Commission to the fact that the efficient as well as the honest conduct of business is essential in the public interest and should be an important factor governing the formula-

tion of all proposals as to statutory provisions and the establishment of regulations thereunder.

All told, 86 proposed amendments are discussed in this report. Of these, 48 relate to the Securities Act of 1933, 2 relate to the Bankruptcy Act, and 36 are concerned with the provisions of the Securities Exchange Act of 1934. Thirty-three of the proposals with respect to the 1933 act are in the area of agreement between the Commission and the representatives of the industry and 15 are in the area of complete or partial disagreement. There is agreement as to the 2 proposals relating to the Bankruptcy Act. Agreement has also been reached as to 20 of the proposals relating to the Securities Exchange Act of 1934 and the remaining 16 proposals as to the 1934 act are in the area of complete or partial disagreement. The position taken with respect to each proposal is shown for the 1933 act and the Bankruptcy Act in the table of contents which begins at page 1 of this report and the position with respect to each proposal for amending the 1934 act is shown in the table of contents as to that act which begins at page 179 of the report, as well as in the discussion contained in the explanatory statements following each proposal.

#### *As to the 1933 act*

Consistent with their view that revision of the securities acts should seek only to make these statutes more equitable and modify their provisions governing procedures so as to make it possible to transact business more efficiently without impairing the protection afforded to investors by the requirement of fair and adequate disclosure of information as to the character of securities offered or sold to the public, the proposals of the industry with respect to the Securities Act of 1933 have been chiefly concerned with the following problems:

I. The use of information prior to and after the effective date of a registration statement;

II. The requirements as to the use and delivery of prospectuses;

III. Simplification of registration procedure;

IV. The exemption of small issues and of certain classes of issuers and of transactions from the registration procedure, but not from the fraud provisions of the act;

V. The bases of liability under section 12 with respect to the dissemination of information relating to securities already outstanding in the hands of the public;

VI. The scope of the registration requirements of the act as determined by the meaning of the term "public offering"; and

VII. The size and organization of the Commission itself, and the general administration of the act.

The following is an outline of the situation which has developed in the conferences with respect to these problems:

#### I. THE USE OF INFORMATION PRIOR TO AND AFTER THE EFFECTIVE DATE OF A REGISTRATION STATEMENT

Section 5 establishes the basic procedures of the act with respect to the registration of issues of securities and the use of prospectuses. It governs the making of offerings, sales and deliveries of securities. Proposals with respect to changes in section 5 are presented at page 85 of this report. Related proposals concerning the use of information prior to and after the effective date of a registration statement are contained in the drafts of section 2 (3) (p. 9) and of section 2 (10) (p. 19). All of the provisions of the act are, however, related to section 5 in one way or another.

One of the basic difficulties by which issuers, underwriters, dealers and the investing public have been confronted in transacting business under the Securities Act of 1933 arises from the fact that the theory of the present act that information should be made freely available to investors prior to the effective date of a registration statement conflicts in practice with the provisions of the present act requiring that prior to the effective date of a registration statement no sales, or solicitations to buy or offers to buy may be made or accepted.

The proposals with respect to section 5 presented in this report, taken together with the proposals as to section 2 (3) and section 2 (10), would retain the prohibition against the making of any sale, including any contract to sell, prior to the effective date of a registration statement. But they would remove one



great difficulty by providing a workable means for making information available to investors and by permitting offerings (but not sales) to be made during the waiting period.

A substantial measure of agreement was reached in the conferences as to the broad concept of the amendments which are necessary and desirable in this connection. But the Commission has expressed its opposition to the proposed amendments and has taken the position that the proposals as to section 5 and related sections, presented in this report, should not be accepted by the Congress. On the other hand, the representatives of the industry are convinced that many of the difficulties which exist today will continue in aggravated form and many new difficulties will be created if the requirements which have now been conceived by the Commission are translated into law.

The position taken by the representatives of the industry is simply that there should be freedom to give information to investors and to make offerings by means of a "limited prospectus" as soon as a registration statement has been filed, but that no sale of any security should be permissible until after the effective date of the registration statement. Even then, for the first 7 days of the public offering, a sale would be permissible only upon compliance with one of two conditions. Either (a) a general prospectus must have been sent or given to the purchaser so that it would normally have been received by him on the day before the sale is made, or (b) not later than the next business day, he must be sent or given a prospectus and a written confirmation of the sale telling him that he has an absolute right of cancellation if, not later than noon on the first business day after he receives the written confirmation, he advises the seller that he has examined the general prospectus and that he elects not to proceed with the purchase. Since offerings made before a registration statement becomes effective would, in the normal course, be made for execution on the first day of public offering after the effective date of the registration statement, the representatives of the industry believe that the above conditions with respect to sales made during the first 7 days of public offering are fully adequate to insure that investors to whom such offerings are made will have every reasonable opportunity to obtain and study prospectuses before entering into binding purchase contracts.

The disagreement with the Commission hinges on whether it should be permissible to make a sale in the manner just outlined or whether the statute should prohibit the making of any sale to any person in connection with a new issue distribution, by a person engaged in such distribution, at any time on or after the effective date of the registration statement, unless proof has been established that the buyer has had a general prospectus for at least 24 hours and for not more than 30 days. This would not only be a burdensome requirement but would be one which, owing to the facts of time and geography, would permit almost immediate purchase of securities by large buyers in the city where the offering is initially made but would prevent many other investors and the smaller dealers throughout the country from participating in attractive new issue distributions on a lawful basis, even though they are already thoroughly familiar with the affairs of the issuer.

Under the act as it stands today and as it has stood since it became law on May 27, 1933, section 5 has clearly authorized the making of oral offerings of securities and of binding sales contracts after the effective date of a registration statement without requiring, as a matter of statutory law, that a prospectus be delivered to the purchaser prior to the time when the security is delivered to the purchaser, as long as it is delivered at the same time. In practice, dealers in the investment banking business make prospectuses available to prospective purchasers as soon as they can be obtained, which is usually on the first day of public offering after the registration statement becomes effective. If any written offering is made the present law requires that, at the time of such written offer or prior thereto, the person to whom the communication is sent must be provided with a section-10 prospectus except where the written offering does no more than identify the security, state the price thereof, and indicate by whom orders will be executed.

With respect to the greatest percentage of new issue securities measured by dollar amount, as in the case of trading transactions in investment securities generally, business between buyer and seller is normally conducted by telephone. A security salesman in the investment banking business is not an itinerant who is here today and gone tomorrow. He is a man of standing in his community who deals almost wholly with the same people year in and year out. The great



majority of buyers with whom he deals are highly intelligent and well-informed citizens. Many of them are professional buyers, trustees, officers of corporations, banks, insurance companies, or other financial institutions. A Federal statute prohibiting oral offerings to be made by dealers in securities by telephone to such buyers after the effective date of a registration statement would make it exceedingly difficult if not impossible to carry on an investment banking business. The Congress, in enacting the Securities Act of 1933, clearly recognized this fact after the problem was presented to it and clearly provided in section 5 for the making of oral offerings after the effective date of a registration statement. The Commission, however, now desires to strike this provision out of the law and to prohibit the making of any oral offering to an investor unless the dealer first establishes proof that the investor to whom the oral offering is made has been sent or given a limited prospectus or a general prospectus current at the time of the offering.

When a registration statement relating to a proposed new issue of securities is filed with the Commission, the Commission makes a practice of announcing the fact immediately in the press. If the contemplated offering is one of attractive quality, investors throughout the country turn at once to their security dealers to seek information concerning it and possibly to ask that offerings be made to them at the appropriate time. The great majority of conversations as to such securities, which occur prior to the effective date of a registration statement, ordinarily take place in personal interviews or over local telephones. They do not involve the use of any means or instrumentality of interstate commerce or of the mails. Consequently they are now, and have always been, permissible under the provisions of the Securities Act. The Commission states that this is due to a "loophole" in the act and that it desires now to prohibit such conversations unless the dealer first sends or gives the person with whom he talks some kind of written communication such as an "identifying statement," "limited prospectus," or "general prospectus." If section 5 is otherwise amended in accordance with the proposals which they have made, the representatives of the industry are prepared to accept and recommend this proposed new prohibition as applied to the making of oral offerings prior to the effective date of a registration statement. But they are strongly opposed to the view held by the Commission that a similar prohibition should now be made applicable to all oral offerings made after a registration statement has become effective and full information as to a security has become available to the public and been widely disseminated throughout the country. Nor is it possible to reconcile the attitude of the Commission with the principle that the Securities Act of 1933 is intended to provide for full and fair disclosure of information about securities and for the prevention of fraud in the sale of securities "with the least possible interference with honest business."

The proposals with respect to section 5, which the representatives of the industry recommend to the Congress are discussed in detail in this report beginning at page 85. The industry believes that, when judged against the background of the present statute and of the procedures clearly authorized thereby, these proposals will be found by the Congress, as a practical matter and from the standpoint of hard fact, not only to preserve existing investor safeguards but to go beyond the present law in serving and protecting investors by providing a workable means of making information available to them and in various other ways.

## II. THE REQUIREMENTS AS TO THE USE AND DELIVERY OF PROSPECTUSES

The basic requirements with respect to the use of prospectuses are established by section 5 of the act (p. 85 of the report). Other proposals relating thereto are contained in section 2 (10) (p. 19), section 4 (c) (p. 77), section 4 (d) (p. 81), section 10 (a) (p. 117), and section 10 (b) (p. 119). The proposals as to section 7 (p. 109) are also related thereto.

Except as to the reservations concerning section 5, which have already been mentioned and as to the proposed section 4 (d), there is substantially complete agreement between the Commission and the representatives of the industry as to all proposals concerning the use and delivery of prospectuses. Provided that a simple document of one or two pages is developed and authorized as contemplated by the proposed amendment, the "limited prospectus" should be very useful and helpful. The general prospectus itself should become a more simple and useful document. At present the statute requires that a prospectus shall be used or delivered in respect of every sale made during the period of 12 months follow-

ing the initial public offering of a security registered under the act. Under the proposed amendments there would be no requirement as to the use of a prospectus by an underwriter or dealer participating in the distribution, at any time after completion of the distribution of his commitment. The proposed amendments would also do away with any requirement that prospectuses be delivered in respect of transactions on the floor of a national securities exchange. These changes should greatly reduce costs upon issuers, underwriters, and dealers and simplify the carrying out of transactions in securities in the period following initial public distribution. It is a constructive change. Anyone actually engaged in the initial distribution of a new security would, of course, continue to be under the requirement that each purchaser be furnished with a prospectus.

### III. SIMPLIFICATION OF REGISTRATION PROCEDURE

Section 6 (a) (p. 97) and section 7 (p. 109) would establish important new procedures with respect to the registration of securities under the act. There is agreement between the Commission and the representatives of the industry as to the changes proposed in these sections. Of basic importance is the idea sought to be incorporated in the act by the proposed section 7 (a) (2) which would in certain circumstances do away with duplication and establish the prospectus itself, together with appropriate exhibits, as the registration document. Present procedures require two separate documents, that is, the "registration statement" and the "prospectus." The latter document is to a large extent a duplicate of a substantial part of the registration statement. Existing procedure has, in the opinion of the representatives of the industry, involved unnecessary and costly duplication of effort. The proposed amendment to section 7 should provide a cure for this situation. It also takes the important step of recognizing that when a company has made full public disclosure of information concerning its affairs by the filing of a registration under one Federal statute, it should be under simpler duties with respect to compliance with the disclosure requirements of other Federal statutes than those which are placed on an issuer who has not previously made such disclosure.

### IV. THE EXEMPTION OF SMALL ISSUES AND OF CERTAIN CLASSES OF ISSUERS AND OF TRANSACTIONS FROM THE REGISTRATION PROCEDURE, BUT NOT FROM THE FRAUD PROVISIONS OF THE ACT

The proposals of the industry in this area are set out in the drafts of a new section 3 (a) (9) (p. 43 of the report) and in the draft section 4 (b) (p. 73), section 3 (a) (2) (p. 39), and section 4 (a) (12) (p. 69). Clarification of the exemption of the revenue bonds and other securities of public instrumentalities is sought by the proposal as to section 3 (a) (2). This has been agreed to by the Commission. The proposed section 4 (a) (12) also has been agreed to by the Commission. This would exempt from registration the addition of a guaranty by a foreign government to securities issued by a State or city or other political subdivision of the country.

The most important proposals under this heading, however, fall into the area of disagreement. One of these contemplates that public utility issuers who comply with the disclosure requirements of the registration procedure of the 1935 act should not be required to go through the registration procedure of the 1933 act, but should be exempt therefrom to the same extent that railroad and other issuers subject to the Interstate Commerce Commission are now exempt. As will be seen from the discussion at page 43, this proposal is not made for the purpose of exempting issuers from liabilities. Another proposal as to which disagreement exists would raise the permissive exemption of small issues from the present statutory limit of \$100,000 to a figure of \$500,000. The Commission has agreed that the maximum exemption be \$300,000. The industry believes that while this would be a helpful relief to small companies who find that it is virtually prohibitive to comply with the full requirements of Federal registration, it does not go far enough in this direction. Since the exemption would be permissive, it is thought by the industry that an increase in the top limit to at least \$500,000 is desirable. As noted on page I, an amendment of this character was proposed in the bill introduced by the Honorable Mr. Lea on May 17, 1940 (H. R. 9807) and in an identical bill (S. 4006) introduced in the Senate on May 20, 1940, by Senator Johnson, of California.

## V. THE BASES OF LIABILITY UNDER SECTION 12

The representatives of the industry have sought to amend section 12 so as to differentiate between the liabilities attaching to prospectuses on new issues which are being initially distributed and the liabilities attaching to the giving of information concerning securities which are already outstanding in the hands of the public. Prior to the passage of the Securities Act dealers in securities made available to their customers analyses of outstanding securities (not new issues) which were designed to give an investor the salient facts with respect to a security. These analyses did not purport to contain all relevant information, but were clearly marked as "outlines" or "summaries" or "analyses." In many instances comparative data with respect to various other securities were made available. Since the present statute became law, however, many brokers and securities dealers have not found it possible to provide this type of outline, summary, or analysis for the use of their customers because of the fear that they might subsequently be charged with having omitted to state a material fact and they doubted their ability to prove, as required by the act, that in the exercise of reasonable care they could not have found out about the omission.

The Commission and the representatives of the industry are in agreement as to a revision of section 12 which would substitute a new section 12 (b) and a new section 12 (c) for the present section 12 (2). The new section 12 (c) would apply only to the giving of information as to securities which are not at the time subject to the registration or prospectus requirements of the act. It should prove helpful in enabling brokers and dealers to give their customers informative summaries without assuming undue liabilities with respect thereto. The statute would, however, continue to impose liabilities fully adequate to insure that the dealer act in good faith and with reasonable ground to believe that there was no untrue or misleading statement in the information supplied by him.

## VI. THE SCOPE OF THE REGISTRATION REQUIREMENTS OF THE ACT AS DETERMINED BY THE MEANING OF THE TERM "PUBLIC OFFERING"

The proposed section 2 (14) (p. 31) is concerned with this question. It involves the whole scope of the registration requirements of the act. The proposal which has been put forward for a definition of the term "public offering" would require the registration of issues, of \$3,000,000 or more, sold directly to insurance companies and certain other purchasers. The Commission has stated that it does not oppose this proposal. The annual report of the Commission for the year ended June 30, 1940, shows that about \$2,700,000,000 of securities were sold by issuers to insurance companies and other direct purchasers in the course of the past 5 years without registration under the act. This practice has done great injury to underwriters and dealers and has deprived the smaller investors and the smaller institutions throughout the country of the opportunity of acquiring any part of many attractive new corporate investments. The proposed amendment would in no sense prohibit the direct purchase of issues by insurance companies, but it would require that in all cases where securities are sold in transactions "affected with a public interest" because they involve investment of the funds of policyholders, depositors, or investors, there be compliance with the registration requirements of the act. Transactions of a private character would continue to be exempt from registration.

## VII. THE SIZE AND ORGANIZATION OF THE COMMISSION ITSELF AND THE GENERAL ADMINISTRATION OF THE ACT

The proposed amendment to section 4 (a) of the Securities Exchange Act of 1934 is being recommended by the representatives of the industry and is discussed at page 14 of the report. Its purpose is to bring about greater continuity of office within the Commission itself by providing increased rates of salaries, lengthened tenure of office, and retirement pay. The proposal also contemplates an increase in the size of the Commission. The point is that important decisions under the acts should always be made by the men who carry statutory responsibility for the determination of policy. The Commission has stated that it is opposed to the suggestion that the number of Commissioners be increased from five to nine and that it believes it would be inappropriate for it to comment on its tenure of office and its salaries.



The second proposal under this heading involves a restatement of the purposes of the act and embodies the idea that a factor to be considered at all times in the formulation of policies and regulations is the need in the public interest to permit honest business to be efficiently conducted. The Commission has stated that it has no objection to the suggested change in the title of the act. A similar proposal concerning the Exchange Act is also being submitted in agreement with the Commission.

#### *Other proposals related to the 1933 act*

An important matter as to which there is disagreement is the draft of section 12 (d) (p. 153 of the report) in which the Commission proposes that the liabilities attaching to reports filed under the 1933 act be greater than the liabilities now imposed by section 18 (a) of the 1934 act (pursuant to sec. 15 (d) of that act) when issuers now register securities under the 1933 act. The representatives of the industry have proposed an alternative section 12 (d) which would carry over into the 1933 act the present provisions of section 18 (a) of the 1934 act as to such reports.

There is also disagreement as to the definition of the term "underwriter" as proposed in item 6 at page 23. The Commission proposes that it be given authority to exempt certain classes of persons from the duties and section 11 liabilities of underwriters, and the representatives of the industry oppose this change. In view of the situation created by administrative and other requirements that certain issues of public utility and other corporate securities be sold in compulsory competitive bidding, the representatives of the industry are recommending, in disagreement with the Commission, that dealers who purchase securities under conditions imposed by such a requirement (the Commission's rule U-50 issued under the Public Utility Holding Company Act of 1935 is an example) should not be subject to the duties and liabilities of underwriters. These matters are discussed at pages 26 and 27.

#### *As to the 1934 act*

The proposals made by the representatives of the industry with respect to the Securities Exchange Act of 1934 have been made with a view to permitting the more efficient functioning of the Nation's securities markets without impairing in any way the protection afforded to investors by the provisions of the act. These proposals of the industry have been chiefly concerned with the following problems:

- I. The scope of the provisions of the Exchange Act;
- II. Simplification and clarification of the registration process;
- III. Elimination of the threat of segregation;
- IV. Extension of credit on new issues.

An outline of the situation which has developed in the conferences with respect to these proposals follows:

#### **I. THE SCOPE OF THE PROVISIONS OF THE EXCHANGE ACT**

Proposals with respect to this problem are set forth as to section 7 (d) at page 193, section 8 at page 199, section 14 at page 243, and section 16 at page 257 of this report.

Under the proposed section 7 (d), the Board of Governors of the Federal Reserve System would have authority to regulate loans made for the purpose of purchasing or carrying any equity securities whether or not such securities are equity securities registered on an exchange.

It is also being suggested in agreement with the Commission that the regulation of borrowing and of capital condition under section 8 be extended so as to apply to all registered brokers and dealers as well as to members of exchanges and brokers and dealers who transact business through such members. There is, however, disagreement as to certain of the substantive changes which the Commission has proposed with respect to the provisions of section 8 dealing with capital requirements and the segregation of customers' securities and moneys.

A further problem relating to the scope of the act is its application to issuers. It has been proposed that the proxy regulations authorized by section 14 be extended so that they will be applicable to securities of all large companies which



are widely held and not solely to securities registered on exchanges. The exchanges believe that the duty of corporations to provide their securityholders with information in respect of action which securityholders are asked to take should not be made dependent on whether or not the securities are listed on an exchange. The representatives of the Investment Bankers Association of America and of the National Association of Securities Dealers, Inc., while making no recommendation with respect to this proposal, do not oppose it. The exchanges give it their strong support. The Commission has stated that it believes that it would be beneficial to the investing public to extend to corporations generally the disclosure requirements of the proxy rules, and that it therefore does not oppose the suggested amendment.

Another problem related to the scope of the act deals with section 16 which applies to trading in the equity securities of their own companies by officers, directors, and large stockholders. One part of the proposal is that the reporting requirements of the section be extended to the directors, officers, and substantial stockholders of all large companies which are in general comparable to those companies whose securities are listed on the exchanges. The representatives of the Investment Bankers Association of America and of the National Association of Securities Dealers, Inc., while making no recommendations with respect to the proposal, do not oppose it. The exchanges urge its adoption. The Commission has stated that the adoption of this proposal would provide an additional important safeguard to the investing public, and that it therefore does not oppose the suggested amendment.

All of the representatives of the industry recommend that subsection 16 (b) be repealed. This subsection grants to every corporation which has stock listed on a national securities exchange the right to sue any of its officers or directors and any person who owns more than 10 percent of its listed stock, if the officer, director, or stockholder buys and sells, or sells and buys, within any period of 6 months any of the corporation's stock and makes a profit. In a suit under this subsection a corporation is allowed to demand for itself the profit which the officer, director, or stockholder, has made. It is the view of the representatives of the industry that the punitive provisions of this subsection are unnecessary to the protection of investors since provision for full and prompt publicity with respect to transactions by officers, directors, and principal stockholders, is made in subsection 16 (a). It is believed that full and prompt publicity is the most potent weapon against the abuse of information. The Commission is opposed to the repeal of section 16 (b).

## II. SIMPLIFICATION AND CLARIFICATION OF THE REGISTRATION PROCESS

The proposed new subsection 12 (g), page 237 of this report, is concerned with this problem. Under present practice an issuer which has registered securities under the 1933 act is required to go through another registration process to register its securities on an exchange even though the information contained in the second registration duplicates to a large extent that contained in the earlier filing.

The proposed amendment recognizes the desirability of eliminating this duplication insofar as possible. It receives general support.

The present statute is not clear as to the conditions under which the Commission may permit an exchange to allow dealings in securities which are to be issued in the future. In reorganizations or recapitalizations, holders of securities may wish to dispose of one or more classes of securities which they will receive in exchange for present holdings. To clarify the authority of the Commission to permit registration of such unissued securities an amendment is proposed to section 12 (d) at page 231. This proposal is concurred in by the industry and the Commission.

## III. ELIMINATION OF THE THREAT OF SEGREGATION

To remove the threat that persons engaged in the securities business may be compelled to give up either their brokerage or their dealer business, the representatives of the industry have proposed an amendment to section 11 (a) at page 211, an amendment to section 11 (b) at page 213, and a proposed new subsection 11 (e) at page 219.

The problem affects more than 70 percent of those engaged in the securities business including specialists in securities on the floors of exchanges and the many small dealers throughout the country.

The Securities Exchange Act directed the Commission to make a study of the feasibility and advisability of the complete segregation of the functions of broker and dealer and to report thereon to the Congress not later than January 3, 1936. Pursuant to this direction a report was made after 18 months of study. No definite conclusion as to the feasibility and advisability of complete segregation was reached.

Since 1934 the entire industry has operated in a zone of uncertainty. The proposal made by the representatives of the industry would end this. The Commission is opposed to this proposal and states that it intends to continue its study. This would have the effect of prolonging the uncertainty. In the opinion of the representatives of the industry it is not probable that additional study would bring forth any additional information, data, or facts not already in the possession of the Commission and available to the Congress.

#### IV. EXTENSION OF CREDIT ON NEW ISSUES

The representatives of the industry and the Commission are in agreement as to a proposal with respect to the maintenance or extension of credit presented under section 11 (d) at page 215. Today a broker and dealer who has engaged in the distribution of a security as a member of a selling syndicate or group is prohibited for a period of 6 months from extending credit to customers on that security. This has made it difficult for brokers and dealers to extend credit to customers on any securities of an issue which they have distributed. While in some respects the proposed amendment would extend the present prohibition, it would limit it to the period during which the broker and dealer is actually distributing a security.

#### *Other proposals related to the 1934 act*

In addition the Commission is advancing various proposals for amending the 1934 act. Many of the Commission's suggestions are procedural rather than substantive; but others if adopted would result in a broad extension of its present powers. These proposals are discussed in the explanatory statements which appear in this report.

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The representatives of the industry believe that the proposals they are putting forward as to the two acts relate to changes in the law essential to the efficient conduct of their business. If accepted by the Congress and translated into law, these proposed changes will in no sense weaken the basic provisions of either the Securities Act of 1933 or of the Securities Exchange Act of 1934 nor deprive investors of adequate protection. But they will do much to aid business.

These proposals of the industry are accordingly submitted along with those as to which agreement has been reached, with the request that all may receive the sympathetic consideration of the Congress.

Respectfully submitted.

Investment Bankers Association of America: Emmett F. Connelly, President; Robert McLean Stewart, Chairman, Securities Acts Committee; Arthur H. Dean, Robert G. Page, Counsel, Securities Acts Committee. National Association of Securities Dealers, Inc.: Robert W. Baird, Chairman; Nevil Ford, Representative; Stewart S. Hawes, Representative; Paul W. Frum, of Counsel. New York Curb Exchange: George P. Rea, President; Francis Adams Truslow, of Counsel. New York Stock Exchange: Emil Schram, President; Howland S. Davis, Executive Vice President; Samuel L. Rosenberry, of Counsel.

### EXHIBIT No. 3

#### PROPOSALS OF FERDINAND EBERSTADT FOR AMENDMENT OF THE SECURITIES ACT OF 1933

The following brief summary of certain provisions of the Securities Act of 1933 may be helpful in considering the recommendations made below:

The Securities Act was enacted for the purpose, among others, of providing adequate information concerning securities offered for sale to the public. Such information is contained in a registration statement filed with the Securities and

Exchange Commission. The registration statement is a questionnaire to be answered by a company issuing securities. In the case of many items, the answers must be supported by voluminous exhibits filed as part of the registration statement. Almost all of the answers to questions contained in the registration statement are required to be incorporated in a prospectus—a circular or selling document which must be given to all prospective purchasers of the security before a sale can be consummated. The entire registration statement consists, then, of the questionnaire, the prospectus, and exhibits.

The original intention of Congress was to have the registration statement become effective 20 days after the filing date. During this period investors were to have an opportunity to examine the registration statement as a document of public record or were to be entitled to receive a copy of the registration statement upon payment of the Commission's charge for copying. Only after the 20-day period elapsed were underwriters or dealers to be permitted to solicit offers or to sell, and then only after a copy of the prospectus had been delivered to the prospective purchaser either prior to or contemporaneously with the security. Recognizing that the 20-day waiting period was arbitrary and, in many cases, unnecessary to accomplish the purposes of the act, by an amendment to section 8 in August 1940, Congress gave the Commission authority to reduce the waiting period in appropriate cases.

The Securities Act gives the Commission no authority to pass upon the merits of the securities being registered. In fact, the act gives the Commission no express authority to question initially the accuracy or the completeness of the disclosure in the registration statement. In the event of misleading statements, nondisclosure or fraud, either prior to the effective date of the registration statement or after such effective date the Commission is given authority to issue a stop order preventing or suspending the effectiveness of the registration statement.

It is, however, the practice of the Commission to review the registration statement as originally filed and thereafter to mail to the issuer suggestions and comments as to what should be added, deleted, or changed. These suggestions or recommendations of the Commission, for which there seems to be no legal basis, are contained in an informal document from the Commission to the issuer called a "memorandum of deficiencies." Presumably such letters contain the Commission's views as to deficient or misleading information contained in the registration statement as originally filed. It is fair to say that a substantial number of the deficiencies cited by the Commission relate to matters which are not really material.

Thereafter the issuer files an amendment to the registration statement in response to the "memorandum of deficiencies." The filing of the amendment starts the 20-day waiting period anew, except that the act provides that an amendment filed with the consent of the Commission shall not delay the effectiveness of the registration statement. Thus the theoretical 20-day waiting period is very much a matter within the control of the Commission. It has the power to accelerate the waiting period so that a registration statement can become effective in less than 20 days. It likewise has the power to prevent a registration statement from becoming effective in 20 days by continuing to find "deficiencies" in the registration statement.

With the above brief summary of certain features of the Securities Act in mind, the following specific recommendations are offered for the consideration of the committee:

1. The Commission should be given the power to exempt from registration issues up to \$1,000,000 as against the present limit of \$300,000.

Until May 15, 1945, the Commission's power to exempt issues from registration was limited to those of \$100,000 and under. By Public Law 55, approved on that day, the Commission's power was extended to issues up to a maximum of \$300,000. Congress appears to have recognized that, balancing the protection of investors against the administrative difficulties and expenses involved in the registration of securities, there is a minimum below which it is unwise to extend the thorough supervision which is involved in the registration process. I submit that the minimum ought to be considerably higher than the \$300,000, and that \$1,000,000 would probably be a proper amount.

This proposal would go a long way toward freeing the flow of investment capital into small businesses and new companies. Many such companies were expanded during the war aided by Government advances or credit in some form. In the immediate postwar period, many of these companies as well as many



others will require additional equity capital to finance operations previously financed by the Government. The uncertainties, delay, and expense involved in the registration process are particularly onerous for small companies.

An exemption from the registration process as is proposed here would not mean that such issues would be exempt from all regulation. In the first place, almost all States have their own securities commissions. In the second place, and perhaps more important, an exemption from registration under the Securities Act of 1933 does not remove such issues from policing by the Commission under the fraud and misrepresentation provisions of section 17 of that act. In this connection, it should be noted that the Commission already requires issuers, who are exempt because of the small size of the issue, to file with the Commission copies of all selling literature, together with other information, so that the Commission is in a position to see that the fraud and misrepresentation provisions are not violated.

2. Special exemptions from registration should be provided for companies

(a) who have already had securities listed on a national securities exchange, or (b) who have previously filed a registration statement under the Securities Act of 1933 and have filed with the Commission the annual reports required by that act, or (c) whose securities must be exempted by the Commission or approved for sale by the Commission under the Public Utility Holding Company Act of 1935, or (d) who are subject to regulation under the Investment Company Act of 1940, or (e) the issue of whose securities is regulated under section 204 of the Federal Power Act.

In the case of all of the above companies, there is already in the hands of the Commission and available for public scrutiny a vast fund of information. The regular financial services carry a description of the company's securities, a record of earnings and dividends over a number of years, the location of plants, volume and type of business done, its subsidiaries, and other information designed to give the investor knowledge of the company's affairs. Nevertheless, when an issue of securities is proposed by such an issuer, it must go through the same detailed registration process, involving vast duplication of work and effort, as a company which for the first time is coming into the market with its securities and thus for the first time is making public information concerning its affairs. This involves a great deal of waste of time and money.

Two alternative proposals could be made to avoid this duplication:

A. All issues of securities of the companies in the classes set forth above could be exempted outright from the registration process. (For example, securities subject to regulation by the Interstate Commerce Commission under section 20 of the Interstate Commerce Act are already exempt from registration.) Such issues would nevertheless remain subject to the fraud and misrepresentation provisions of the act and to the policing powers of the Commission.

B. As an alternative, it could be provided that, in lieu of a registration statement, issuers of the classes mentioned might be required only to file a prospectus containing such information as the issuer considered material, which prospectus should become effective immediately on filing. If desired, the liabilities applicable to a registration statement could be made applicable to a prospectus so filed. This requirement would not in practice involve any real duplication of work as even if a prospectus were not required by law one would undoubtedly be used. This has proven to be the case where issues of railroads subject to Interstate Commerce Commission regulation are involved. The prospectuses as used on such railroad issues are models of quality, brevity, and clarity as compared with those of issues registered under the Securities Act of 1933.

3. Where full registration is required, certain amendments to make the registration process less burdensome for the issuers should be adopted:

(A) The Commission should be required to send to the issuer within 10 days of the original filing of the registration statement a memorandum of deficiencies, if any, citing only material defects. An amendment to the registration statement meeting the objections raised in the memorandum of deficiencies should become effective automatically 5 days after its filing unless the Commission orders it effective sooner.

A provision of this character would (a) enable the Commission to express its views as to deficiencies in a registration statement, but would direct the Commission to confine its comments to material matters; (b) compel the Commission to act with reasonable promptness; and (c) place the effective date of the registration statement within the control of the issuer, thus both permitting a more



exact timing of offerings than is now possible and also preventing the Commission from holding up indefinitely the effective date by continuing to cite deficiencies.

(B) An amendment to a registration statement which merely furnishes the offering price and other information dependent upon offering price should become effective automatically upon its filing with the Commission.

As a matter of practice, it is customary to file a final amendment showing the offering price, and information dependent upon the offering price, at the last moment, and then request the Commission to accelerate the effectiveness of the registration statement. Fluctuating prices in the securities market make this practice an absolute necessity. The above proposal is intended to eliminate the necessity of obtaining the Commission's consent to the filing of the price amendment for the purpose of accelerating the effective date of the registration statement.

(C) Contracts should not be required to be filed as exhibits, at least when they are not sufficiently material to require summarizing in the prospectus.

Under the registration form most used currently, there is no requirement that "material contracts" as such be summarized in the prospectus. Nevertheless, they are required to be filed as exhibits, and the definitions of materiality are such as to include a vast mass of documents. It is doubtful whether a single investor (as distinct from a competitor) ever obtains and examines a copy of the contracts so filed. The printing and filing of such exhibits involves substantial and entirely unnecessary expense and delay.

(D) It would probably be advisable to abolish schedule A to the Securities Act.

Schedule A sets forth in very considerable detail information which must be included in a registration statement and in a prospectus. Experience has shown that it is impracticable to set forth in a statutory enactment information requirements which will be properly applicable for all types of issuers and issues. Accordingly, in certain circumstances, section 7 of the act authorizes the Commission to waive the information called for by schedule A. The Commission has exercised such authority sparingly. The abolition of schedule A would completely free the Commission's hands to prescribe, on the basis of its 11 years' experience, the information and exhibits which the Commission really regards as material.

(E) The act should state explicitly that the Commission has no authority to establish uniform accounting procedures.

The act certainly contains no grant of such authority and it does not appear that Congress intended to confer it on the Commission. However, the Commission, by indirect methods, including the use of its discretion in postponing the effective date by refusing to consent to amendments, etc., has indicated a tendency toward forcing the adoption of uniform accounting methods. The purpose of the Securities Act is to require fair disclosure, but this does not preclude leaving issuers and their accountants free to adopt any standard and proper method of accounting involving fair disclosure.

(F) The issuer should be permitted to register securities even if it has no present intention of offering them for sale.

The Commission construes the present statute as preventing the registration of securities unless the issuer promptly thereafter intends to make an offering thereof. There are many cases in which a substantial saving in expense and trouble would be effected if this rule were changed by an amendment of the statute. It could be required that the investor be informed of the terms of offering by the filing of a posteffective amendment to the prospectus prior to the actual offering of the securities for sale.

4. The act should provide that no underwriter or dealer need use a prospectus after he has ceased to participate in the distribution of the security.

Under the present statute every dealer must deliver a prospectus in connection with each sale which takes place within 12 months after the date of the initial public offering. The proposed amendment would make the use of the prospectus necessary only by a dealer actually engaged in the distribution process. After the distribution process is complete, neither the issuer nor the underwriters are specially interested in further transactions in the security and the security is dealt in in the public market just as the securities of any other issuer are dealt in. To require use of a prospectus after the distribution has been completed seems wholly unnecessary, and it involves a considerable expense to issuers in providing a large number of prospectuses.

5. The act ought to be amended in several respects to make possible better and more complete dissemination of information to dealers and others than now prevails prior to the effective date of the registration statement.

At the present time the act forbids an offer to sell, or solicitation of an offer to buy, a security, as well as the sale of a security, prior to the effective date of the registration statement. This tends to conflict with the theory of the act that the waiting period would be a period during which dealers and investors had an opportunity to inform themselves as to the nature of the issuer and of the security. The conflict arises because of the difficulty of distinguishing in practice between the furnishing of information to dealers and others, on the one hand, and the making of an offer to sell or soliciting of an offer to buy a security, on the other.

In general, the only way to meet this difficulty would seem to be to permit the making or soliciting of offers prior to the effective date as long as no contract or commitment is made prior to the effective date.

(A) Even before filing a registration statement, an underwriter ought to be able to consult dealers and furnish them with information, probably in summary form, to ascertain whether the dealers are interested and on what terms.

This practice ought to be permitted whether or not the furnishing of such information amounts to an offer, or the solicitation of an offer, as long as no contract is made. In many instances, the underwriters cannot know whether an issue is salable without consulting other dealers. Under the present practice the issuer may be put to the expense of filing a registration statement before the underwriters can find out the reaction of the dealers to the proposed offering. Certainly before introducing any product in any other business, it is customary to ascertain the prospect of the product in the market.

(B) The law ought to permit the making of offers by means of the prospectus prior to the effective date, at least after the prospectus has been amended to meet the Commission's memorandum of deficiencies.

After the registration statement has been filed, it has been the practice of many underwriters to distribute, prior to the effective date, so-called red-herring prospectuses, marked with a red legend to the effect that the prospectus is not final and does not constitute an offer or a solicitation of an offer. The debates in Congress at the time the Securities Act was being considered clearly indicate that Congress intended that the investor should have an opportunity to study the prospective issue during the waiting period. However, under the language of the act itself it is difficult to see why distribution of such a prospectus to a dealer or prospective investor is not in fact the solicitation of an offer, and the law ought to be amended to expressly sanction this practice. At the least it ought to be provided that an offer, but not a contract of sale, can be made by means of the prospectus after it has been amended to meet the Commission's memorandum of deficiencies, and prior to the filing of the price amendment.

(C) Both before and after the effective date of the registration statement, offers by means of a limited prospectus or summary prospectus ought to be permitted.

The present prospectus is a bulky and unreadable document which simply is not read by the ordinary investor. If the use of a limited or summary prospectus were authorized the ordinary investor would know a great deal more than he does today about the security he is buying. He should, of course, be told that the complete prospectus is available to him if he wants to examine it.

As an alternative, it might be desirable to provide that such a limited or summary prospectus should be used only in conjunction with the regular prospectus; thus any investor who wanted to go beyond the limited prospectus would have the general prospectus before him.

(D) The act should be amended to permit an issuer to include in the prospectus, or to disseminate as supplemental sales literature, catalogs showing the issuer's products, drafts, charts, illustrations, photographs, or other visual devices which will convey to the investor a more complete idea of the nature of the issuer's business and products than is possible through mere description in a printed prospectus.

Although nothing in the present act would seem to prohibit such a practice, the Commission in its practical interpretation of the act has effectively barred this practice in at least many cases.

The proposal made above would enable the issuer to make the prospectus a more interesting and graphic document, and, therefore, one more likely to be read and understood. There would seem to be no reason why the prospectus should not be an interesting sales document so long as it satisfies the disclosure requirements of the act and is not misleading.

(E) The scope of permissible advertisements should be broadened.

The law gives the Commission authority to classify prospectuses according to the nature and circumstances of their use. Pursuant to such authority the Commission has authorized the use of newspaper prospectuses. While the information set forth in such prospectuses may be expressed in condensed or summarized form, the Commission's requirements are such that, in practice, brevity is impossible of accomplishment. Consequently the use of newspaper prospectuses is negligible.

The law also expressly permits the use of a notice which states from whom a prospectus may be obtained and, in addition, does no more than to identify the security, state its price, and state by whom orders will be executed. Such notices are today known as tombstone advertisements. They are absolutely meaningless to anyone who is not already familiar with the issuer involved, and are certainly insufficient to enable a reader to decide whether or not he is interested in seeing a prospectus.

It would seem that some form of advertisement between the permissible extremes of a newspaper prospectus and a tombstone advertisement should be provided. This could be accomplished if underwriters were permitted to publish and distribute a notice which states from whom a prospectus may be obtained and, in addition, does no more than state the business of the issuer, describe briefly the security being offered, state by whom orders will be executed, state the price, indicate the yield if the security is a bond, describe any redemption or conversion feature, describe any right or warrant which may be exercised with respect to the security, indicate whether the security is a legal investment for institutional investors, indicate the extent to which the issuer has agreed to pay any tax with respect to the income from the security, and contain the symbol or trade-mark of the issuer.

6. It would be desirable to amend the act to exempt from the liability of underwriters any class of persons who do not themselves take part in the distribution.

Under the present act it is believed that a person, such as an investment trust, who merely agrees to buy and hold unsubscribed portions of an issue of securities would be subject to the liabilities of an underwriter even though they take no part in the distribution of the issue. The risk that the underwriter's liability would exist might in many cases be insufficient to prevent an investment trust or other institution from making such an agreement. It is believed that the underwriter's liabilities ought properly to attach only to those who take part in the actual distribution and selling of securities.

7. The act ought to be amended to permit, in express terms, the making of preliminary agreements between a selling stockholder and an underwriter, and agreements between the underwriters themselves, prior to the effective date of the registration statement.

The present act permits agreements between an issuer and an underwriter to be made prior to the effective date. In practice, with the knowledge and approval of the Commission, agreements are also made between the selling stockholders and underwriters prior to the effective date, and, of course, agreements between the underwriters themselves are also made. It would be desirable to amend the act to eliminate any possible doubt as to whether these practices are lawful.

8. It is also respectfully suggested that the act should require that a certain percentage of the members of the Securities and Exchange Commission be individuals who have had a substantial experience in the securities business.

This might make advisable an increase in the membership of the Commission.

Although there has been a high turn-over in the membership of the Commission since its creation, very few of its members have had any experience in the securities business. It would really seem desirable to have on the Commission some persons with experience in the diverse fields which are subject to regulation by the Commission, such as investment banking, stock brokerage, public utilities, and investment companies. The absence from the Commission of any substantial number of members with experience in the business may account for the failure of the Commission to recommend to Congress the changes which would enable the acts to function more effectively without interfering with their basic purposes.



I wish to emphasize that these are my own recommendations and that I am not representing any group or organization. I also want to make clear that these proposals are not necessarily the only proposals nor the best to meet the real difficulties which exist. They are made in response to the committee's request.

The substance of many of the above recommendations has already been made to the Commission and to the Congress by others. I would refer you to the following:

(a) S. 3985, S. 4006, H. R. 9807, and H. R. 10013 (76th Cong., 3d sess.).

(b) August 7, 1941, Report of the Securities and Exchange Commission on the Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, printed for the use of the Committee on Interstate and Foreign Commerce (77th Cong., 1st sess.).

(c) July 30, 1941, report on the conferences with the Securities and Exchange Commission and its staff on proposals for amending the Securities Act of 1933 and the Securities Exchange Act of 1934 by representatives of the Investment Bankers' Association of America, National Association of Securities Dealers, Inc., New York Curb Exchange, and New York Stock Exchange.

(d) Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives (1st sess.), on a comparative print showing proposed changes in the Securities Act of 1933 and the Securities Exchange Act of 1934, etc., Government Printing Office, 1941.

JUNE 20, 1945.

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### EXHIBIT No. 4

NEW YORK 6, N. Y., June 2, 1945.

HON. WILLIAM M. COLMER,

*Chairman, Special Committee on Postwar Economic Policy and Planning,  
House of Representatives, Washington, D. C.*

DEAR CONGRESSMAN COLMER: I thought your committee might be interested in having the following, which, if time had permitted, I would have introduced as exhibits to my testimony:

Exhibit 1: Corporate issues in the United States from 1920 to date. You will notice that the total from 1920 through 1929 amounted to \$41,000,000,000, whereas the total from 1930 through 1944 amounted to less than one-fifth of this. This is, of course, not all due by any means to SEC regulations.

Exhibit 2: A summary of issues registered under the SEC Act of 1933, whereas exhibit 3 is a summary of the corporate issues. The distinction between the two generally is that some of the issues referred to in exhibit 2 were sales by stockholders as opposed to direct issues by corporations.

Exhibit 4: Gives the time that appears to have been required to clear some recent issues.

Exhibit 5: A digest of the report of the Twentieth Century Fund relating to new capital requirements.

Exhibit 6: Gives some expense data on some of our own recent issues.

I want to thank you for the courtesies extended to me at the time of my appearance before your committee.

Sincerely yours,

F. EBERSTADT.



EXHIBIT 1.—Corporate issues in the United States from 1920 to date <sup>1</sup>

	New capital				Refunding				Grand total
	Long-term bonds and notes	Short-term bonds and notes	Stocks	Total	Long-term bonds and notes	Short-term bonds and notes	Stocks	Total	
1920.....	\$1, 117, 390, 900	\$557, 435, 742	\$1, 035, 184, 744	\$2, 710, 011, 386	\$117, 055, 700	\$103, 339, 245	\$35, 898, 363	\$256, 293, 311	\$2, 966, 304, 697
1921.....	1, 390, 403, 420	163, 069, 366	299, 532, 065	1, 852, 004, 851	503, 808, 080	52, 362, 000	9, 732, 880	567, 902, 960	2, 390, 907, 811
1922.....	1, 646, 582, 435	115, 646, 000	573, 505, 772	2, 335, 734, 207	657, 751, 215	29, 311, 000	50, 486, 025	737, 548, 240	3, 073, 282, 447
1923.....	1, 900, 043, 057	143, 270, 700	639, 182, 398	2, 702, 496, 155	416, 350, 543	37, 216, 800	76, 776, 599	530, 343, 942	3, 232, 840, 097
1924.....	2, 137, 031, 423	335, 422, 800	829, 821, 541	3, 302, 285, 764	412, 205, 077	67, 606, 000	36, 464, 233	516, 275, 300	3, 838, 571, 064
1925.....	2, 592, 201, 375	297, 107, 250	1, 211, 416, 542	4, 100, 725, 167	448, 001, 425	89, 225, 000	99, 554, 099	637, 384, 524	4, 738, 109, 691
1926.....	2, 893, 898, 530	282, 418, 795	1, 130, 685, 425	4, 307, 002, 750	754, 072, 970	51, 391, 900	137, 086, 100	942, 550, 970	5, 299, 553, 720
1927.....	3, 612, 638, 340	269, 188, 300	1, 504, 181, 904	5, 391, 002, 544	1, 577, 771, 360	86, 313, 200	264, 105, 700	1, 928, 187, 260	7, 319, 195, 804
1928.....	2, 789, 176, 450	219, 744, 800	3, 070, 631, 166	6, 079, 602, 416	1, 127, 416, 500	54, 373, 800	556, 454, 315	1, 738, 274, 615	7, 817, 877, 031
1929.....	2, 344, 412, 679	206, 329, 933	6, 088, 696, 948	8, 639, 439, 560	497, 901, 290	56, 308, 217	832, 721, 092	1, 386, 921, 569	10, 026, 361, 129
10-year total.....	22, 443, 798, 609	2, 589, 633, 686	16, 427, 888, 505	41, 472, 320, 800	6, 514, 334, 130	628, 048, 165	2, 099, 300, 396	9, 241, 682, 691	50, 703, 003, 491
Average.....	2, 244, 379, 861	258, 963, 369	1, 642, 788, 851	4, 147, 232, 080	651, 433, 413	62, 804, 817	209, 930, 040	924, 168, 269	5, 070, 300, 349
1930.....	2, 842, 567, 855	556, 734, 150	1, 545, 101, 161	4, 944, 403, 166	405, 476, 155	100, 220, 000	23, 179, 722	528, 875, 877	5, 473, 279, 043
1931.....	1, 163, 488, 600	288, 698, 750	311, 281, 373	1, 763, 468, 723	677, 305, 200	116, 361, 500	31, 830, 000	825, 516, 700	2, 588, 965, 423
1932.....	271, 048, 000	34, 121, 500	20, 192, 125	1, 325, 361, 625	134, 796, 800	179, 894, 000	3, 842, 920	318, 533, 720	2, 643, 895, 345
1933.....	23, 621, 000	16, 675, 000	120, 421, 178	160, 717, 178	114, 870, 500	73, 678, 200	32, 317, 778	220, 866, 478	381, 583, 656
1934.....	112, 106, 600	31, 550, 000	34, 601, 349	178, 257, 949	174, 931, 500	137, 905, 000	81, 498, 993	312, 836, 500	491, 094, 449
1935.....	322, 943, 836	11, 294, 125	69, 331, 997	403, 569, 958	1, 743, 114, 814	39, 245, 000	81, 498, 993	1, 863, 858, 807	2, 267, 428, 765
1936.....	826, 456, 877	23, 032, 500	367, 460, 922	1, 216, 950, 299	3, 174, 814, 723	39, 737, 500	200, 443, 159	3, 414, 995, 382	4, 631, 945, 681
1937.....	770, 738, 140	48, 566, 080	407, 725, 572	1, 227, 029, 801	1, 809, 505, 351	46, 873, 920	352, 329, 675	1, 208, 708, 946	2, 435, 738, 747
1938.....	786, 521, 370	3, 582, 000	64, 314, 842	854, 418, 212	1, 387, 477, 525	2, 758, 000	31, 143, 964	1, 221, 379, 489	2, 075, 797, 701
1939.....	584, 584, 433	4, 310, 000	98, 758, 509	983, 433, 032	1, 602, 954, 567	74, 300, 000	137, 158, 821	1, 812, 713, 388	2, 196, 166, 420
1940.....	589, 121, 030	12, 010, 000	135, 251, 752	736, 382, 782	1, 806, 953, 271	26, 561, 000	192, 680, 756	2, 026, 193, 056	2, 632, 577, 838
1941.....	865, 014, 085	24, 247, 535	172, 393, 780	1, 062, 201, 383	1, 411, 351, 632	18, 881, 965	126, 189, 766	2, 612, 577, 746	2, 713, 804, 746
1942.....	502, 926, 070	3, 200, 000	118, 750, 956	624, 878, 026	405, 496, 280	1, 300, 000	10, 640, 970	417, 637, 256	1, 042, 620, 276
1943.....	263, 623, 429	22, 500, 000	91, 748, 916	377, 872, 345	605, 454, 071	15, 300, 000	82, 041, 715	702, 895, 786	1, 080, 868, 131
1944.....	427, 814, 687	2, 000, 000	222, 707, 658	652, 522, 345	2, 162, 298, 313	10, 750, 000	257, 822, 425	2, 460, 870, 758	3, 113, 563, 083
Total 1934-44.....	5, 749, 450, 549	186, 492, 240	1, 781, 598, 343	7, 767, 541, 132	15, 082, 832, 046	414, 012, 385	1, 501, 920, 274	16, 998, 794, 705	24, 716, 335, 837
Average 1934-44.....	522, 677, 323	16, 953, 840	161, 963, 486	770, 606, 103	1, 371, 166, 550	37, 637, 490	136, 540, 934	1, 545, 344, 973	2, 246, 939, 622
1945 to May 1.....	127, 094, 000	-----	115, 691, 809	242, 785, 809	1, 151, 798, 500	44, 000, 000	88, 422, 488	1, 284, 220, 988	1, 527, 000, 797

<sup>1</sup> Includes all known issues. For the years since 1933 only a fraction of these issues have been registered with the Securities and Exchange Commission.

Source: The Commercial &amp; Financial Chronicle.

EXHIBIT 2.—*Summary of all issues registered under Securities Act of 1933*

{Figures are in thousands}

Year ended June 30—	Corporate issues				Sales by other than issuers	Total offerings	Total amount registered <sup>2</sup>
	New capital	Refunding	Purchases of securities for investment and affiliation	Other <sup>1</sup>			
1935 .....	62,326	440,901	144,360	3,559	4,498	690,737	913,130
1936 .....	354,407	3,018,621	395,631	13,794	86,524	4,022,590	4,835,049
1937 .....	913,473	2,158,985	388,705	32,472	119,327	3,753,935	4,851,463
1938 .....	460,028	467,158	346,409	5,269	32,328	1,381,138	2,101,186
1939 .....	437,494	1,239,393	237,797	33,549	48,516	2,068,429	2,579,193
1940 .....	162,774	1,068,999	114,656	34,259	54,467	1,487,248	1,786,537
1941 .....	286,814	1,485,039	239,699	6,547	189,722	2,270,671	2,610,684
1942 .....	590,785	751,938	83,263	7,804	61,781	1,526,941	2,003,421
1943 .....	64,195	287,208	107,935	8,271	69,867	555,795	659,480
1944 .....	204,328	815,238	269,883	2,444	103,614	1,450,461	1,759,780
Total, 1935-44 .....	3,536,624	11,733,480	2,328,338	147,968	770,644	19,207,945	24,099,923
Average, 1935-44 .....	353,662	1,173,348	232,834	14,797	77,064	1,920,795	2,409,992
1945 to Mar. 31 .....	251,393	1,292,032	226,578	743	94,409	-----	2,079,607

<sup>1</sup> Includes purchase of assets and other miscellaneous purposes.<sup>2</sup> Includes, in addition to amount offered for immediate sale, warrants, options, stock reserved for conversion, etc.

Source: Tenth Annual Report of the Securities and Exchange Commission and Statistical Bulletins of such Commission.

EXHIBIT 3.—*Summary of corporate issues, compensation, expenses, and net proceeds to issuer, under Securities Act of 1933*

Year ended June 30—	Corporate issues: Price to public	Distributing compensation	Expenses of issuer	Net proceeds to issuer
1935 .....	\$686,239	\$29,558	\$5,494	\$651,186
1936 .....	3,936,066	126,238	27,374	3,782,454
1937 .....	3,634,608	114,950	26,023	3,493,635
1938 .....	1,348,810	60,084	9,862	1,278,864
1939 .....	2,019,914	59,168	12,513	1,948,233
1940 .....	1,432,781	43,201	8,891	1,380,688
1941 .....	2,080,949	51,895	10,955	2,018,099
1942 .....	1,465,160	23,024	8,345	1,433,790
1943 .....	485,928	15,648	2,671	467,609
1944 .....	1,346,846	47,037	7,916	1,291,893
Total, 1935-44 .....	18,437,301	570,803	120,044	17,746,451
Average, 1935-44 .....	1,843,730	57,080	12,004	1,774,645
1945 to Mar. 31 .....	1,837,166	56,372	10,050	1,770,745

Source: Tenth Annual Report of the Securities and Exchange Commission and the statistical bulletins of such Commission.

EXHIBIT 4.—*Time required for registrations to become effective with Securities and Exchange Commission—Data given below cover issues between Jan. 1 and May 22, 1945*

Number of days	Number of companies	Percent	Number of days	Number of companies	Percent
0 to 20 .....	56	36.2	61 to 70 .....	2	1.3
21 to 25 .....	38	24.6	71 to 80 .....	-----	-----
26 to 30 .....	22	14.2	81 to 100 .....	1	.6
31 to 35 .....	15	9.7	101 to 200 .....	1	.6
36 to 40 .....	7	4.5	200 to 250 .....	3	1.9
41 to 45 .....	5	3.2	Total .....	155	-----
46 to 50 .....	3	1.9			
51 to 60 .....	2	1.3			

## EXHIBIT 5

The attached schedule contains estimates of the Twentieth Century Fund of capital outlays in the postwar period.

The maximum capital outlay of \$28 annually is the amount which will be needed, assuming our population and labor force continue to grow as in the past and employment and production are maintained at a level as high as that in the last half of the twenties.

The minimum capital outlay of \$12 annually is the amount which would be needed to cover only those outlays for which there would be heaviest pressure because of population growth and the expansion and replacement made necessary by a high level of industrial activity.

J. Frederick Dewhurst, economist for the Twentieth Century Fund, in his statement before the Special Committee to Study Problems of American Small Business of the Senate, said:

"Entirely aside from any questions which may well arise regarding the accuracy of these estimates, it goes without saying that the mere existence of a 'need' for \$28,000,000,000 worth of capital goods per year does not mean that this need will translate itself into effective demand, or in other words that the need will be met. Some needs are more urgent than others, and the level of employment, production, and income that we are able to achieve in the postwar period will be the most important determinant, not only of the magnitude of our needs for capital goods, but of our ability to meet such needs. In any event this tentative estimate of \$28,000,000,000 per year (at 1940 prices) should be regarded in the nature of a maximum program which is probably beyond our capacity, even under favorable conditions."

"The probability is, of course, that our actual expenditures for capital goods in the postwar decade and a half will fall between these two extremes and even under conditions of full employment and full utilization of our productive capacity we would fall short of producing enough capital goods to meet the maximum estimate of needs."

*Maximum and minimum programs of estimated capital outlays in selected fields, 1946-60*

[In millions of dollars]

Fields selected	Maximum program		Minimum program	
	Total	Annual average	Total	Annual average
I. Urban development:				
1. Nonfarm housing .....	75, 973	5, 065	29, 133	1, 942
2. Public water supply systems .....	3, 945	263	718	48
3. Sewerage systems .....	3, 695	246	503	33
4. Hospital facilities .....	5, 164	344	712	47
5. School facilities .....	12, 935	863	2, 864	191
6. City service streets .....	5, 390	359	2, 100	140
Subtotal, urban development .....	107, 102	7, 140	36, 030	2, 401
II. Commercial and industrial:				
1. Commercial building .....	10, 200	680	8, 400	560
2. Industrial facilities .....	52, 600	3, 507	52, 600	3, 507
3. Electric power systems .....	22, 155	1, 477	16, 485	1, 099
4. Telephone facilities .....	6, 357	424	1, 272	85
Subtotal, commercial and industrial .....	91, 312	6, 088	78, 757	5, 251
III. Transportation:				
1. Railroads .....	16, 100	1, 073	-----	-----
2. Highways .....	33, 118	2, 208	-----	-----
3. Waterways and port development .....	2, 250	150	-----	-----
4. Airport development .....	1, 500	100	1, 500	100
5. Pipe lines .....	535	36	40	3
Subtotal, transportation .....	53, 503	3, 567	1, 540	103

*Maximum and minimum programs of estimated capital outlays in selected fields, 1946-60—Continued*

[In millions of dollars]

Fields selected	Maximum program		Minimum program	
	Total	Annual average	Total	Annual average
IV. Rural development:				
1. Farm housing.....	5,760	384		
2. Farm service buildings.....	4,205	280		
3. Irrigation.....	1,657	111	77	5
4. Drainage.....	1,194	79	79	5
5. Clearing.....	3,100	207	90	6
6. Soil-erosion control.....	4,980	332	1,620	108
7. Flood control.....	3,226	215	806	54
8. Forest protection and development.....	1,895	126	515	34
9. Recreational facilities.....	2,353	157	413	28
Subtotal, rural development.....	28,370	1,891	3,600	240
Total.....	280,287	18,686	119,927	7,995
Other <sup>1</sup> .....	140,143	9,343	59,963	3,997
Grand total.....	420,430	28,029	179,890	11,992

<sup>1</sup> Items I-IV above usually represent about ¾ of all capital expenditures. Other capital items, usually accounting for the remaining ¼, include agricultural, mining, and construction machinery, office equipment, and business motor vehicles.

**EXHIBIT 6.—*Issues of F. Eberstadt & Co.***

	Amount of issue	Net proceeds to company	Attorneys' fees	Accountants' fees	Printing	Percent such expenses to net proceeds
<i>1945</i>						
Hewitt.....	\$1,874,665.50	\$1,311,000.00	\$10,000	\$3,500	\$6,500	1.53
Armstrong.....	3,400,000.00	3,190,000.00	<sup>1</sup> \$12,500		11,400	.72
Aircraft Radio.....	940,500.00	790,875.00	12,500	6,000	5,350	3.11
King-Seeley.....	2,000,000.00	1,830,000.00	15,250	11,250	8,550	1.92
<i>1944</i>						
Aeronca.....	918,000.00	756,250.00	6,000	1,000	6,045	1.72
Gleaner.....	3,198,402.00	2,976,290.50	7,500	2,750	3,000	.45
Heller.....	2,860,000.00	2,767,960.00	16,000	2,500	6,300	.86
Semler.....	1,063,650.00	931,960.00	5,000	3,000	5,000	1.39
Westvaco.....	3,552,500.00	3,456,250.00	4,000	2,000	11,000	.49
Elliott (preferred).....	2,500,000.00	2,375,000.00	10,000	2,000	5,800	.75

<sup>1</sup> Represents combined attorneys' and accountants' fees.

**EXHIBIT 5**

**A SPECIFIC PROGRAM FOR MUNICIPAL FINANCE DURING THE WAR AND IN THE POSTWAR YEARS**

By CARL H. CHATTERS, Executive Director, Municipal Finance Officers Association of the United States and Canada

SUMMARY OF A TALK BEFORE THE CONFERENCE COMMITTEE ON URBAN PROBLEMS,  
CHAMBER OF COMMERCE OF THE UNITED STATES, FEBRUARY 8, 1944

Prior to making the specific recommendations below, certain statistics were given to indicate the financial condition of cities with respect to their debts, assessed valuations, tax collections, and other current indexes of financial position. The specific recommendations have been listed below:

1. Municipalities should continue to reduce their debts and continue toward a pay-as-you-go basis until their postwar needs are so great that borrowing is the only alternative.



2. Municipalities should continue to eliminate short-term borrowing and should enter the postwar period with balanced budgets and no carry-over short-term loans.

3. Municipalities should continue to set up reserves for postwar use and these reserves should be protected and held until their use will make the greatest contribution to recovery.

4. Municipalities must control the development and use of land in order to control both operating costs and capital costs.

5. While municipal public works will provide employment for only 3 to 8 percent of the numbers who may need jobs in the postwar period, still these public works if carried on at the proper time can be a stabilizing element. The timing and the extent of local public works will determine to some degree the amount of Federal and State aid need by municipalities.

6. Unless public works are built around a master plan, the construction of new public works may set back permanent redevelopment for a generation or more.

7. If there are any Federal or State grants for public works or employment relief, then we come to the inescapable conclusion, based on the experience of depression years, that municipalities which are prepared with good plans and some money of their own, will obtain something of permanent value while the others will do "leaf raking" or nothing.

8. Harold D. Smith, Budget Director of the United States, made an important point in a recent speech when he said we need to remember that public works are not just built for themselves but are constructed to meet a public need and furnish public services.

9. The amount of money available from municipal funds alone for postwar construction and reconstruction is not determined by the amount of deferred maintenance or deferred public works but is really limited to the sum of (a) the reserves, (b) the salable loans that the electorate and governing bodies will approve, (c) mild increases, if any, in local tax rates, and (d) shifts from expenditures for present operating costs to expenditures for construction and reconstruction. The amount of money thus available will run somewhere between  $1\frac{1}{2}$  and 3 billion dollars a year for 5 years. A further limitation should be imposed by the cost of operating new facilities recognizing that not only the capital costs but the operating costs represent a long-term commitment.

10. The States should share with their localities the revenue derived from motor-vehicle users and from other such activities where the activities cause direct and unusual expenditures at the local level.

11. Federal aid will be necessary and justifiable in a few areas now most affected by war industry and war activity. The cost of extending such aid may be kept at a minimum by distributing aid where it is needed and to the extent it is needed. The more the States can do the less the Federal Government will need to do. When Federal grants are made the needs are met and then an entire layer of funds is distributed over the entire country, regardless of need. Where the need is not great, the States and the localities should make honest effort to meet it. (At this point I discussed at length the added costs of meeting need and then putting another layer of funds over the entire country or the entire State. I presume that the cost of meeting the need by Nation-wide grants is five times as great as it would be if it were politically possible to confine the distribution of funds to the places which really were in need of help. The same reasoning is applied when State aid is given to localities.)

12. Whether or not Federal aid is extended on a large scale after the war, the Federal Government should start now to plan the course of postwar activities in the areas most seriously affected by the war. In general, the municipalities whose affairs have been most dislocated by war activities have been unable to divert money or attention to their postwar conditions. All levels of government will profit if the planning in these areas can be done now, even though the Federal Government may have to take the leadership and spend the money in these localities to the exclusion of others. On the other hand, the vast majority of cities should do their own planning for their public works.

13. Vast amounts of surplus Federal materials are available now and will become available during the war and immediately after the war. The States and localities should be permitted to obtain part of the materials and supplies which they can use.

14. A determination of Federal policies on postwar grants and postwar public works would help the localities with their planning now. It is impossible for either the States or the localities to make postwar plans with respect to relief and public works unless they know what the Federal policy will be.

15. Grant-in-aid policies need to be revised. The grants from the States or from the Federal Government should cover a broad, instead of a very limited, purpose. A smaller amount of grants will do far more good in this way and cause less disruption of States and local services. Where the grants are made for a very limited object, they stimulate one narrow activity, frequently at the expense of all other activities.

16. There may be need for some Federal agency to extend credit on a sound basis to municipalities in the same way that the PWA did through the RFC during the depression years. For many municipalities this will be a highly desirable alternative to grants or gifts. The history of the loans made to municipalities by the RFC and PWA indicate the soundness of the loans as they were made. The loans can be made in such a way that they need not interfere with the ordinary channels for the distribution of municipal securities.

17. Inflexible State constitutions have prevented the States and their municipalities from developing the proper form of fiscal policies and governmental structure at the State and local level. The State constitutions must be revised to bring about economy of Federal and State funds, to permit rational State administration of finances, and to facilitate the revision of the local revenue systems and the abolition of inadequate local units of administration.

18. In bringing all these things to pass, there is the greatest need for some citizen agency on a national level to promote unbiased citizen interest in the genuine needs of the States and localities. Such an agency should develop leadership at the State and local level, and should support policies and programs for the general benefit of all the citizens. Unless such an agency is formed, or a general revival of citizen interest is aroused, there will be a progressive centralization of Government at the Federal level, a progressive weakening of the States and localities, and a tendency away from the responsible government now lodged with the States and localities. I do not mean the type of taxpayer association which is selfish. Even though my own interests are largely along fiscal lines, I can see little hope for the States and localities except through some general wave of interest in government aimed at the general welfare of the country.

19. Finally, municipalities can best prepare for the postwar period by putting their houses in order now. What they do now, determines what they will be compelled to do and what they will be compelled to accept in the postwar era. Municipalities that are weak at the end of the war must spend their time at the mercy of others. But the municipalities which take constructive steps now by—

- (a) Establishing reserves of money and credit;
- (b) Reorganization of activities;
- (c) Removing shackles imposed by State constitutions, State statutes and local laws and charters;
- (d) Developing realistic plans around a master plan;

these municipalities will be best fitted to meet any war or postwar demands that may be made upon them.

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